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National Interest and International Cartels

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National Interest and International Cartels

by

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THE MACMILLAN COMPANY
NEW YORK · 1946

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First Printing

PRINTED IN THE UNITED STATES OF AMERICA
BY J. J. LITTLE & IVES COMPANY, NEW YORK

PREFACE

To ASSIST in clarifying an issue as controversial as that presented by international cartels, a writer must accomplish two main tasks: he must undertake to discover the questions that would arise in an intelligent reader's mind and must contribute, so far as facts and his own powers permit, to finding answers to these questions.

This study, which attempts to meet these specifications, is deliberately interpretive in character. It is a product of the belief that the times call for a critical examination of the flood of contentions pro and con, and of the mass of data brought to light in recent years, rather than for further effort to discover new evidence on particular cartels or on the cartel problem in general.

The ideas expressed in this book will probably not meet with the unqualified endorsement of that host of economists, lawyers, and students of public affairs who have already committed their views on cartels to print. It is my hope, however, that this formulation of conclusions on major cartel issues may contribute to the progress of thought on the subject in the same way that the writings of others, both those with which I agree and those with which I disagree, have contributed to the development of the views presented here.

I wish to acknowledge the assistance derived from discussions with many businessmen, lawyers, government officials, economists, and political scientists. The manuscript

was read in its entirety by Percy W. Bidwell, Thomas K. Finletter, John A. Stevenson, and Clair Wilcox, and the chapter on patents by the dean of patent lawyers, William H. Davis. They are responsible for the removal of many defects but are absolved from responsibility for faults which have survived their efforts.

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National Interest and International Cartels

Chapter I

THE CARTEL PROBLEM

A CARTEL is an association of independent enterprises in the same or similar line of business which exists for the purpose of exercising some sort of control over competition. It is an international cartel if the members are domiciled under more than one government or do business across national frontiers. A simple description, suggested by an official of the Department of Justice, of what is embraced under cartel practices is that they include everything that would be held to be in conflict with the antitrust laws if carried on within the United States.

THE NATURE OF CARTELS

Cartels are a particular manifestation of the all but universal quest for economic security. "Stability," freedom from "cutthroat" competition—which is likely to signify the particular competition to which the person using the expression "cutthroat competition" happens to be subject—and the elimination of uncertainty regarding markets and prices are to many producers what an established wage rate and an assured job are to workers. The fact that cartelization gives participating members a greater feeling of security largely explains its appeal to so many businessmen, but from the standpoint of national policy it fails to establish a conclusive justification for cartels. No one would say that economic security (in all its possible forms) is worth the price that must be paid for it. Indeed, it is precisely because of a belief that the security gained

by means of cartels may lessen incentive, restrict output, impede international trade and interfere with the effective operation of the price system that cartels are under such vigorous attack in this country.

The first significant aspect of cartel agreements is that the members participating in the cartel retain their independence. It is this feature that distinguishes cartels from mergers, for example, where the independence, and often the identity, of the individual enterprise disappears. The other significant feature of cartel agreements is that they involve a departure from free competition. It is this that distinguishes them from ordinary buyer-seller contracts such as exist between manufacturers in one country and the merchants in another country who handle their products.

Cartels are merely one among several, not always clearly distinguishable, monopolistic forms of business organization, including pools, combines and trusts. They vary greatly in form and content, and range from loose associations held together by informal understandings to firmly established organizations, based on strong contractual agreements, which may even enjoy governmental participation.

The term international cartel, and largely, therefore, the analysis to which it relates, will be confined in the following pages to international business arrangements of the types in which American concerns, most of them engaged in manufacturing, have been involved. Where the discussion is extended to other international agreements to which the term is sometimes attached, e.g., intergovernmental controls over agricultural and mineral commodities and conventions relating to transportation by sea and air, the extension will be clearly indicated.

The reason for entering into cartel agreements is partly

to reduce market risks to which they would individually be subject. The "risks" cartels are designed to reduce are particularly such competitive hazards as the sudden lowering of price as a result of "cutthroat" competition, the entry of new sellers into the market, the disturbance of markets and the endangering of established capital values through the unexpected introduction of new processes. Cartel agreements may be concerned with any of a variety of business practices relating to such matters as terms of sale, price, production, technical methods, division of markets and the exchange of patent rights and information.[1]

Critics of the cartel system are likely to see in the departure from competition a desire to establish a monopoly in order to raise prices and obtain excessive profits. The friends of cartels regard it as a means of establishing order in an industry and of bringing about a greater degree of stability of output, prices, and return than would otherwise prevail. It is sometimes said that cartels represent an attempt to take the loss out of the profit-and-loss system.

CARTELS AND AMERICAN PUBLIC OPINION

To most Americans, cartels are an alien, and more especially a German, institution. They have incurred the special antipathy which the war aroused toward all things

[1] Cf. Corwin Edwards, *Economic and Political Aspects of International Cartels*, Subcommittee on War Mobilization of the Committee on Military Affairs, U.S. Senate, 78th Congress, 2nd Session, Monograph No. 1, Washington, 1944 (hereafter cited as Edwards Report), pp. 1-9; Idem, "International Cartels as Obstacles to International Trade," American Economic Review Supplement, March 1944, pp. 330-331; Clair Wilcox, *Competition and Monopoly in American Industry*, T.N.E.C. Monograph No. 21, pp. 215 ff.; and Karl Pribram, *Cartels*, Washington, 1935, pp. 18-19 and 40.

German and non-democratic.[2] The use made of cartel connections to promote German military and political designs and the charge that American businesses were duped in the process further added to their disrepute, as did the fact that cartels were made the instrument for extending German control over the economic life of occupied countries. The question is seldom raised whether our unfortunate experience with German cartels is to be attributed to the cartel form of organization or to the fact that they happened to be under the control of the Nazis. Rightly or wrongly, the point has been reached where the word "cartel" has become less a name than an epithet. The editor of *The Economist* remarked that in the United States, "the word 'cartel' has become an indiscriminate imprecation. The campaign [against cartels] has roots, of course, in the familiar trust-busting tradition, but this particular variant has romantic features all of its own. The wicked cartellist has taken the place of the wicked arms manufacturer in popular demonology. Any attitude that is unpopular, whether it be the British stand on civil aviation or opposition to the dismantling of German heavy industry, is indiscriminately attacked as the handiwork of the cartel interests." [3]

[2] The Nazis, for their part, are said to have opposed free competition as "liberalistic." They contended that it is anti-social because of a tendency to create unemployment through bankruptcies and consolidations. Cartels were said to help preserve smaller middle class firms and to prevent the spread of big business. William Kessler, "German Cartel Regulation Under the Decree of 1923," *Quarterly Journal of Economics*, August 1936, pp. 691-92. Cf. the statements of Professor J. Anton de Haas of Harvard that "free competition is not the answer" and "the alternative of cooperation will be international chaos," *International Cartels in the Postwar World*, New York, American Enterprise Association, 1944, pp. 17, 47.

[3] *The Economist*, December 2, 1944, p. 724.

The emotional implications associated with the term cartel render any dispassionate discussion of the problem more difficult, and confusion has been further confounded by appropriating the word to uses for which it was never intended. Thus the Bretton Woods proposal was referred to by a hostile writer as a "monetary cartel," railroads operating in the South have been called a "freight-rate cartel" and, to complete the picture, an aggregation of organizations supporting the Republican candidate for President was described as a "cartel" of conservatives.

It is significant, however, that the stigma attached to the word "cartel" has by no means entirely discredited the practices it identifies. Many businessmen, lawyers and laymen who are interested in foreign trade or fear competition from foreign countries are convinced of the desirability of entering into cartel agreements with foreign companies. They hold that such agreements are a means of effecting a mutually advantageous exchange of technical knowledge and of assuring more orderly business conditions. They maintain, even, that to remain aloof from cartel agreements might make American entry into foreign markets difficult if not impossible. Late in 1944 the National Foreign Trade Council passed a resolution recommending that "the standard of competition between Americans and foreigners, and thus also between competing American firms, be determined by the requirements of the applicable foreign law." [4]

On the other hand, representatives of big business and small have denounced international cartels. The National Association of Manufacturers enacted resolutions condemning cartels. Eric A. Johnston, then president of the United

[4] *The New York Times*, October 12, 1944.

States Chamber of Commerce, and others speaking for small business expressed their vigorous and unqualified opposition to legalizing cartels.[5] The president of the Sun Oil Company declared that the existence of cartels "is the primary reason for the backwardness of European industry compared with our own. . . . Their effect has been to destroy initiative; close the door of opportunity for new individual entrepreneurs and small business units; encourage inefficiency; raise prices and thus lower the standard of living. . . . A cartel under the aegis of governments is no less reprehensible than a cartel entered into by individuals. Both are detrimental to the public welfare." [6]

Such a division of opinion on the question of monopoly and competition has perhaps always existed. Fifty years ago a widely circulated book declared that "what we call Monopoly is Business at the end of its journey." [7] Yet Theodore Roosevelt, at the time he was carrying on an active campaign against monopoly, stated that "in the modern industrial world combines are absolutely necessary. . . . Some of these combines are among the most powerful of all instruments for wrongdoing. Others offer the only effective way of meeting actual business needs." [8]

In this statement of Theodore Roosevelt lies the key to the diversity of opinion on the subject of cartels. There

[5] In the United States it is generally assumed that cartels are opposed to the interests of small producers. It is said that in Germany they were regarded as protecting the small producer. Cf. Franz Neumann, *Behemoth*, New York, 1942, p. 267, and Kessler, *loc. cit.*

[6] J. Howard Pew, *The Economic Record*, October 1944, p. 89.

[7] Henry Demarest Lloyd, *Wealth Against Commonwealth*, New York, 1894, p. 6.

[8] *Congressional Record*, March 25, 1908, p. 3854. (Quoted in Bruno Burn, *Codes, Cartels, National Planning*, New York, 1934, p. 43.)

is no single cartel stereotype, yet the problem is characteristically discussed in terms of absolutes. Opponents of international cartels are likely to condemn any sort of monopoly in American foreign trade; opposition is expressed to any departure from antitrust legislation for the sake of benefitting exporters. So doctrinaire an attitude is itself a deviation from the policy followed in this country. Even the Sherman Act came to be interpreted in the light of a "rule of reason." In domestic trade monopolies are commonly accepted in the case of railroads and public utilities. In these instances we have accepted the idea of "good" monopolies, and have provided means for keeping them good. As will be seen later, proposals have been made to differentiate in somewhat the same manner between good and bad cartels in the international field.

EFFECT OF WAR ON THE CARTEL PROBLEM

In a variety of ways, war brings about conditions which are likely to stimulate interest in forming cartels. It upsets economic conditions and alters accustomed ways of doing business; and cartels and cartel policies provide a refuge against the real and imaginary disturbances which form a part of postwar calculations.[9] Overcapacity in particular lines of production, as the position of rubber, aluminum and shipping bears witness, is an important by-

[9] A Senate subcommittee commented on the serious problem likely to result from the release of stocks of metals owned by various Government agencies. Private cartels were mentioned, though without specific endorsement, as one means of dealing with th problem. *Preliminary Report of the Subcommittee on Mining and Minerals Industry to the Special Committee to Study and Survey Problems of American Small Business*, Senate Subcommittee Print No. 7, 78th Congress, 2d Session. Pursuant to S. Res. 66. Washington, 1944, p. 2.

product of war; and cartels are a favorite device for meeting the problem of overcapacity. Wars may, in addition, give rise to grandiose ideas concerning the possible future course of economic activity abroad and thereby stimulate interest in cartels as a means of controlling or sharing in the economic development of other countries in the years after the war.

The second world war contributed directly to the spread of cartel-like practices through the effect it had on business organization. Under the pressure of war demands, competitors were brought together and induced to cooperate in sharing patents and technical knowledge. To facilitate negotiations between government and business a central agency for an entire industry was sometimes set up, with powers, form and functions approximating a cartel. Many of the policies which businesses were encouraged or obliged to adopt during the war—fixing of prices, standardizing of qualities, division of markets, pooling of sales, elimination of crossfreights—are the very purposes for which cartels are typically created.

The primary motive for abating customary competitive practices among American businessmen when production for military purposes became paramount was the desire to bring about more effective operation of our industrial organization. Patents and technical knowledge were made available to former competitors; production was allocated in such a manner as to facilitate maximum production and minimum duplication; shipments within the country were controlled to permit fullest utilization of transportation facilities; and imports and exports were regulated to economize shipping and facilitate war-time priorities. In addition to promoting essential production and at the same

time expanding output through more efficient use of technical knowledge, capital equipment and material, the greater centralization of administration helped to simplify problems of control, stabilize prices and reduce waste of resources.

No one would suggest that this process constituted cartelization: the organizations set up were under governmental aegis; they were obviously temporary; there is no indication that they were restrictive of total output; and their purpose was the prosecution of the war, not the increasing of profits. Nevertheless, the entire experience constituted an excursion into non-competitive business methods and afforded many parallels with the principles and practices of cartelization.

It is probable also that controls of the sort introduced in time of war tend to breed further controls. The basis of present and future departure from free competition is strengthened by past departure from free competition. The spread of administrative controls into all phases of economic life—agriculture, labor, trade, industry, shipping—not only provides a precedent for centralization of authority but also contributes to the sort of economic rigidities for which cartel agreements are likely to seem an appropriate remedy.[10] Even apart from the other conditions which arise in time of war, the growth of economic rigidities that accompany war is favorable to the development of cartel practices.

It does not follow that because a compromise with cartelization seemed advantageous in this country during the war it is likewise desirable in peace. Some of the advan-

[10] Cf. A. F. Lucas, *Industrial Reconstruction and Control of Competition*, London, 1937, pp. 359-70 and passim.

tages of competition which are highly valued in peacetime become very cheap under pressure of war: during a war it is no longer important or even desirable that production should be guided according to the wants of individuals; other incentives exist besides the income realized by individuals; and it is production-at-once rather than production-at-least-cost that is essential. At the same time, also, the dangers of monopoly are likely to be less forbidding, both absolutely and relative to other dangers confronting the nation, than they are in peacetime. Thus the pursuit of restrictive policies is less probable, partly because it would not be attempted and partly because it would not be tolerated; and at a time when almost everything is scarce there is no disposition to worry about the perpetuation of overcapacity.

The usefulness cartel-like practices may have had during the war provides, it is true, a poor criterion for judging the usefulness of cartels in time of peace. But the fact remains, as wartime experience served to emphasize, that cartels are theoretically capable, under not improbable circumstances, of facilitating a closer approach than would otherwise be possible to optimum methods of operation. It remains to be seen whether, in the long run, the experience with cartel-like policies in war will strengthen the incentive to participate in international cartels under conditions of peace.

In at least one important respect, however, the war was inimical to cartels even aside from its effect on public psychology. During the war, monopolies of technical knowledge by means of patents and trade secrets were weakened or broken down through the confiscation of foreign patents, the pooling of information by domestic

producers and the mastering of technical knowledge under the urgent necessity of producing to meet war needs. To the extent that particular cartels survived in the past because of exclusive control over patents and "know-how," their hold was weakened by the war. Moreover, great strides were made in the production of new articles and of substitutes for old; it is to be expected that some of these discoveries will compete with products formerly under control of cartels.

THE CARTEL PROBLEM TODAY

Interest in the cartel question is greater today than ever before. The tide of anti-monopoly sentiment, which turned following the N.R.A., gathered strength after 1938 when Thurman Arnold took office as head of the Anti-Trust Division of the Department of Justice, and has moved with great force since 1940. There is no simple explanation of the extraordinary prominence of the cartel problem, but a number of clearly recognizable influences, some favorable and some unfavorable to cartels, have helped to bring it to the fore in recent years.[11] The present mood may be partly a reaction from the lax attitude that prevailed in the

[11] The reasons offered here may be compared with a list presented by Corwin Edwards, giving the general reasons for the formation of cartels:

a. The desire of powerful business enterprises to exchange inventions and trade secrets.
b. The desire of established industries to cope with threatened loss of markets.
c. To cope with governmental trade barriers.
d. To maintain the exportation of highly specialized countries.
e. The desire of independent concerns to do business in cartelized markets.—Department of State, Press Release, No. 262, June 20, 1944.

early thirties;[12] enforcement of antitrust legislation had been at a low point for some time and the N.R.A. even went so far as to give legal sanction and encouragement to business agreements restricting competition.

As was noted, wartime economic policies pushed American industries, temporarily, a considerable distance along the road to cartelization. In many instances, the activities of competing concerns were coordinated in the hands of central administrative organizations. At the same time, there was an expansion in the scale of production by very large establishments. The output of many industries was increased far beyond the expected future requirements of foreign and domestic markets. The prospect of a serious disbalance in many lines between output and demand is complicated by the additional fear that the foreign exchange situation may be highly abnormal for a considerable time. Thus the desire for some sort of centralized direction of production and marketing is strengthened by a desire for centralized control over financial operations in order to forestall either disorganized dealings in the exchange markets or arbitrary and discriminatory treatment by exchange authorities abroad.

Cartels have long been described by German writers as "Kinder der Not," children of adversity. It is not without significance that our own abortive gesture toward compulsory cartelization, the N.R.A., was introduced during the period of the great depression. While the desire to expand profits which are already reasonably generous may, no doubt, sometimes give rise to cartels, the risk of losses

[12] During the 1930's expenditures on the account of the Webb-Pomerene section of the Federal Trade Commission amounted to as little as $5,000 a year and its functions resolved into little more than registration and record keeping.

provides a stronger motivation for attempting to reduce competition. Therein lies the significance to the cartel question of the fact that the prospect of losses—resulting from readjustment to a peace economy, overcapacity and heightened competition at home or abroad—was accentuated by the return of peace. It likewise follows that the strength of the public's hostility to cartels and other restrictive economic practices may be expected to meet its severest test should we encounter a prolonged postwar depression.

Notwithstanding the hostility to cartels resulting from the political and economic use made of them by Germany, some sort of international cartel administration was advocated as a means of restoring the industries of liberated Europe to a peacetime basis. Moreover, in a number of countries, notably Great Britain, sentiment in favor of cartels was influenced by fear of the expanding industrial power of the United States and Russia. This fear became more pronounced at the very time when the need of these countries for export markets was most acute.

Throughout the world full employment has been accepted as the goal of economic policy. Attention is directed toward cartels both as an instrument and as an obstacle to the attainment of full employment. On the one side it is maintained that cartels can be made to facilitate economic planning and to promote industrial stability. On the other side it is argued that cartels would introduce rigidity, discourage new enterprises (particularly by small-scale producers), and encourage cautious policies and restrictive practices which would interfere with the objective of maintaining high level employment.

To this combination of factors contributing to the current prominence of the cartel question must be added

psychological considerations, such as the latent hostility to big business, with which cartels are popularly identified, as well as the prevailing attitude toward Germany, with which cartels are also identified. According to one writer, the charges directed against international cartels were deliberately used to provide support for the enforcement of the Sherman Act.[13] It is reported that in 1939 representations were made to Congress to relax antitrust legislation on the grounds that the government's defense program would thereby be facilitated. Fearing that serious damage would be done to the cause of antitrust enforcement, the Department of Justice immediately directed attention toward the pro-Nazi political activities of German cartels with which American companies had relations. Indictments were issued against a number of important American companies for their alleged cartel activities. Not merely was the movement for curbing the antitrust program forestalled, but Congress came forward with substantially increased appropriations to expand the work of the Anti-trust Division.

The basic elements of the cartel problem are always present. What war does, as has been pointed out, is to strengthen the forces making for cartelization and at the same time heighten the opposition. This sharpened conflict represents the merging—but not the fusion—of two streams of thought, the one characterized by a desire for stability in a world of increased uncertainty, and the other impatient of anything that smacks of restriction or of undue influence by foreigners or by big business. The clash of economic forces and economic and social philosophy gives us the cartel problem as it exists today.

[13] *Saturday Evening Post*, September 2, 1944, p. 77.

THE BASIC ISSUE

The kernel of the cartel problem, the essential feature of cartels to which all others are secondary, is that cartels entail a departure from free competition. This departure affects the economic status and the freedom of consumers, of actual and potential competitors and of members of the cartel itself. The issue is simply this: *Is it wise public policy to give legal standing to such a departure from competition?*

If the answer to this question is in the affirmative, we are immediately confronted with the questions of how far and in what lines the departure should be permitted, and what safeguards should be provided. If the answer is in the negative, we have the problem of suggesting a workable procedure whereby American participation in cartel agreements can be prevented.

The case against international cartels as it has developed in recent years in the United States has rested primarily on two contentions. The first is that the existence of cartels is inconsistent with and prejudicial to the maintenance of a free enterprise economy of the type for which the United States has traditionally stood. The second is that cartels, particularly through the use made of them by the Germans, have been a menace to world peace and have seriously threatened the military security of this country.

The leading argument in favor of international cartels is that, whether we like them or not, cartels are one of the established institutions of international trade and American businessmen must be able to participate in them if we are to play an active part in the world trade of the future.

A writer in the *Christian Science Monitor* has said that it is "difficult or impossible in most foreign countries for American firms to do business without either formally joining a cartel or its equivalent, or playing along with it." [14] Mr. Milo Perkins went so far as to declare that "no American firm is strong enough to buck" the sort of cartel arrangements we may expect to encounter abroad after the war.[15] The alleged necessity of participating in international cartels rests only in part on the question of our ability to hold our own on a strictly competitive basis with cartelized foreign producers. Of equal or greater importance is the claim that unless we join foreign cartels and adhere to their regulations we shall be excluded from foreign markets by the legislative action of foreign governments. As a concrete solution it has been suggested that the enforcement of antitrust laws should be confined to commerce taking place within the United States.[16]

The controversy over cartels, particularly as it has proceeded from government officials on the one side and from spokesmen for certain groups of businessmen on the other, runs chiefly along the foregoing lines. The cartel issue turns only partly, however, upon considerations of this character. It frequently happens in social questions that the most popular arguments are not the most logical or significant. That is conspicuously true, as will be seen in what follows, of the dispute over international cartels.

[14] February 1, 1944.
[15] *Harper's*, November 1944, p. 573.
[16] *Business Record*, August 1944, p. 178.

Chapter II

THE BASIC ISSUE: CARTELS IN A FREE ECONOMY

THE most fundamental objection to the cartel system is that it is inconsistent with the functioning of the economic system in a free competitive society. Even though capitalism had its roots in the early English monopolies which facilitated the concentration of wealth and the rise of entrepreneurial power,[1] in this country capitalism is identified with competitive private enterprise. It is no coincidence that monopolistic forms of economic organization reached their highest development in Germany and Russia. Cartels are compatible with state capitalism or socialism, but under individualistic capitalism of the type to which we are committed in the United States they are an anomaly: in an economy based upon the free choice of individuals they restrict the freedom of producers to compete and of consumers to buy.

According to *Fortune*, "cartel devices for twenty years have been destroying the competitive free enterprise system from within." [2] A Canadian writer has declared that if the businessmen of a country "want a government-controlled economy . . . there is no surer way of stimulating public demand for it than by stifling competition and thereby proving that the competitive system is unworkable." [3]

[1] Hermann Levy, *Monopolies, Cartels and Trusts in British Industry*, London, 1927, p. 60.

[2] September, 1942, p. 152.

[3] *Financial Post*, October 14, 1944.

Individualistic competition, whatever its faults, provides an automatic mechanism for guiding economic activity. The struggle for survival which exists under competition favors the selection of the most efficient over the least efficient producers. Under a system of cartels, on the other hand, there is no logical basis for expecting that the fittest, i.e., the lowest cost, producers will remain in operation and the highest cost producers will be eliminated. Nor is there any automatic means, such as exists under competition, of correcting a condition of excess capacity. As will be seen, a cartel is likely to embrace considerable excess capacity, including some that is relatively inefficient.

Competition affords an automatic inducement for the efficient enterpriser to produce. Since the individual producer can expect to earn more the more he produces, there is a constant incentive to expand the output of goods and services available for consumption. Under a system of cartels there is no such presumption of a normal tendency toward expansion of production. With cartels, as with other monopolistic forms of business organization, the way toward increased income may be by way of restriction rather than by expansion of output. In addition, the freedom of entry of new producers is likely to be impeded; and restraint on freedom of entry is inconsistent both with the maximization of output and with the principles of democracy.

PRICE AND PRICE BEHAVIOR

The price policies of cartels cannot be reduced to anything so rudimentary as simply charging what the traffic will bear. It is a mistake to assume that cartels are merely a device for imposing higher prices and realizing higher

profits, even though this may be their uniform tendency. The theory of price determination under a cartel system is substantially that because of the degree of monopolistic power enjoyed price is no longer governed by average or marginal costs, but can be set at a point that accords better with conscious objectives of the cartel. Cartel objectives are usually assumed to focus in higher profits, but other, possibly overlapping, considerations which may also be important include the stabilization of prices, production and profits, the protection of invested capital and the avoidance of a competitive struggle.[4]

Economists are accustomed to think of the economic process as one in which producers have no hesitation to compete as long as there is a prospect of higher profits. Any such generalization is far from realistic. A concern, especially one which is relatively prosperous already, might remain out of a particular market rather than engage in a hard-fought battle to establish itself there, even though it were entirely confident that it would win the battle and in the long run obtain higher profits. This is particularly true if the prospective competitor is already operating in the other market.

The conventional picture of the typical businessman as a bold adventurer always on the alert for larger profits is a questionable abstraction. A more accurate characterization of many established businesses would be a comfortable middle-aged squire who would rather ride than walk, somewhat distasteful of elbowing the crowd, and more dis-

[4] At the same time it is to be noted that cartel practices directed toward the attainment of these other objectives may be just as artificial, and from an economic standpoint just as objectionable, as establishing an excessive price. Cf. R. G. Hawtrey, *Economic Destiny*, London, 1944, p. 339.

posed to leave well enough alone than to run the risk of having his hat knocked off. Because cartels are a means of softening the rigors of competition, they could exist independently of any design to increase profits or raise prices.[5]

Cartels may, nevertheless, be presumed to tend to discourage price cutting both because of the restriction of competition among members and because the large size and strength of the cartel may deter outsiders from engaging in price competition and make them more willing to keep in line with policies laid down by the cartel. What supporters of cartel policies regard as an entirely defensible protection against wasteful cutthroat competition may appear to their critics as a device for achieving monopoly profits. Similarly what one group thinks of as helping to overcome instability of prices is likely to be interpreted by the other group as tending to create price rigidity.

The price effects of international cartels are not to be considered solely in terms of establishing excessively high prices abroad. Cartel and quasi-cartel arrangements have sometimes been directed toward maintaining lower prices in the foreign market than at home.[6] The maintenance of

[5] Professor Myron W. Watkins has remarked that "the burgeoning of the international cartel movement in recent decades may be explained in terms of these factors prompting the businessmen concerned to seek security (at whatever cost of opportunity, not only for themselves, but also for others) in the midst of cumulatively mounting risks of technological obsolescence and shifts in consumer preference." "International Business Cooperation and Cartels," *Proceedings of the Academy of Political Science*, January, 1945, p. 53. Many writers, on the other hand, have maintained that cartels are invariably concerned with increasing profits: "Whatever their scope or type, international cartels are designed to enhance profits." Edwards Report, p. 9.

[6] A lower price abroad than at home—if the difference was not attributed to differences in real cost—might mean that the foreign price was artificially low, or that the domestic price was artificially high.

unduly low prices abroad, i.e., dumping, has led to as much criticism as maintenance of high prices, nor is this necessarily inconsistent since either situation may be entirely artificial. Since price may be altered in either direction, no conclusion is valid which fails to consider that cartels may lower prices abroad as well as raise them.

The most spectacular instances of the price policies of cartels, however, have to do with the high prices they have charged. One of the most famous cases is that of tungsten carbide, an extremely hard substance which is of great use in the machine tool industry and was therefore highly important in production for war. Following the conclusion of a cartel arrangement whereby the principal German supplier agreed to remain out of the United States market, the price of tungsten carbide rose almost immediately from $50 to $453 per pound. It remained above $225 a pound during most of the decade preceding the war. After antitrust proceedings were started early in 1942, the price fell to a range of from $27 to $45 a pound.[7]

The high prices charged for tungsten carbide were made possible by the agreement of the principal foreign supplier to remain out of the American market. However, there was no apparent ground for complaint at the time when we were importing from a foreign, and, indeed, a German cartel. The question is whether the experience reflects on international cartels as such, or on American businessmen and the practice of restricting imports.

The lower foreign price may, of course, be only temporary. Germany, where cartels were most highly developed, is said to have practiced dumping very extensively. Cf. Jacob Viner, *Dumping, A Problem in International Trade*, Chicago, 1924, p. 64.

[7] Edwards Report, pp. 12-13.

Examples such as this, spectacular as they may be, are of questionable value as evidence. Where control arising out of patents permitted, similar abuses have occurred at the instance of domestic companies having no international cartel connections. If it is true that "hard cases make poor laws," it is no less true that extreme examples in the field of economic policy prove little or nothing. Their chief use lies in their emotional appeal.

There are, however, distinct limitations on a cartel's ability to maintain artificial prices even if it desires to do so. In the first place, the number of industries capable of effective cartelization is probably not large relative to the total. Secondly, forces exist within cartels themselves which circumscribe their power. Maintenance of too high a price may defeat itself, as has been repeatedly demonstrated, by attracting additional producers and accentuating competition among members for enlarged sales and production quotas. Conditions within the cartel may determine its stability and its ability to hold together. It may happen that within a cartel, "competition, even cutthroat competition, still goes on. Opponents are compelled to surrender not by price cutting or ruinous underbidding but by the cutting off of supplies of raw materials and capital." [8]

In the third place, cartels may be subject to certain external restraints. In virtually every case there is the threat of competition, whether from producers outside the cartel or from producers of a substitute product. The threat may be significant even if it relates to potential rather than existing production; and the threat may include what D. H. Macgregor referred to as the "power of own-pro-

[8] Neumann, *op. cit.*, p. 292.

duction" by large buyers.[9] Moreover, the wishes of the purchasers, particularly if the bulk of the demand is concentrated in a few buyers, may have to be taken into consideration. And there is the possibility, especially in this country, of provoking some form of governmental interference if monopoly powers are exploited too flagrantly.

The various limitations on the power of cartels are likely to be more effective in a country such as the United States, with a large relatively free market and a competitive tradition, than in a small country. For even the government of a Latin American country may appear relatively small alongside some giant cartel selling in that market. In the United States the size and strength of the government are something of a safeguard against the dangers popularly identified with exceedingly large business organizations. In some parts of the world the business units may be as large as in this country—and conceivably, if organized in cartels, even larger—while the governments may be relatively small. At the same time, a government, no matter how small the country, ordinarily has methods of imposing its will which are not open to even the largest of private enterprises.

An accurate evaluation of the price effects of cartels is impeded by the fact that they are not always clearly traceable. An increase in prices brought about by the activities of a cartel, for example, might be initiated at a point several stages removed from the final sale of the commodity, and consumers would perhaps not be aware that the product was in any way subject to cartelization. Again, the effect on prices may be obscured if the resort

[9] *International Cartels*, League of Nations Economic and Financial, (1927. II. 16), Geneva, 1927, p. 6.

to cartel practices in that part of an industry's operations which is carried on abroad contributes at the same time to restrictive policies at home.[10]

QUALITY OF PRODUCT

The quality of the product sold may be as important as the price charged for it. Manufacturers have sometimes been accused of deliberately lowering quality in order to maintain current sales. Thus electric light bulbs, batteries, razor blades and many other commodities are said to have been constructed in such a way as to wear out sooner than necessary.

Some of the most extreme examples of alleged quality deterioration have been brought forward in connection with the discussion of international cartels. At one time plastic glass was being sold to airplane manufacturers at eighty cents a pound and to dentists at forty-five dollars a pound. A proposal was made to mix arsenic or some other adulterant with the plastic glass powder sold to airplane manufacturers in order to prevent its being re-sold for dental use.[11]

Without attempting to justify either the difference in price or the method considered to maintain the difference, it may be questioned whether this example has very much to do with the cartel issue. The situation was that the company had a monopoly based on a patent freely given by the government. The fact that the company may have had cartel connections was incidental to the fact that it had a patent monopoly and desired to increase profits. Any

[10] Cf. Kurt Weidenfeld, *Cartels and Combines*, League of Nations, Economic and Financial (1926. II. 70), Geneva, 1927, p. 32.

[11] Cf. Bone Committee, Hearings on Patents, Part II, pp. 710 ff., and Edwards Report, pp. 13, 18-19.

company under these circumstances might have decided to follow similar policies regardless of whether it was entirely independent or had cartel connections with other foreign or domestic concerns. The example is doubtless a striking commentary on our patent laws, but it has no direct bearing on the question of permitting international cartels.

The situation was not greatly different in various other instances of objectionable practices widely discussed in connection with cartels. According to the findings of the Kilgore Committee, methods were considered for adding poisonous or irritant substances to pigments developed for use in paint in order to render them unsuitable for dyeing textiles.[12] These stories have tended to grow with the telling. Neither in the case of pigments nor in that of plastic glass is there any indication that the policies were ever seriously considered by higher executives of the companies, let alone put into operation. Even if the policies had actually been adopted, the responsibility would seem to lie with American business and American laws rather than with foreign cartels.

TECHNICAL ADVANCE

Similar uncertainty attaches to the contention that cartels may interfere with economic progress. The existence of combination is said to remove or lessen the incentive to introduce technical advances, since there may be fewer rewards for improving the quality of a product and buyers are less able to protect themselves against a lowering of quality. New and improved methods or products may be withheld or their introduction delayed in order to protect

[12] Edwards Report, p. 37.

invested capital or possibly maintain permanently higher prices.

It might be supposed, on the other hand, that the prosperity and stability of a cartelized industry, as well as the spreading of costs over a larger body of producers, would be favorable to the expansion and intensification of technical research. In support of this view it should be noted that Germany, with all her cartels, has been outstanding for research.[13] On the continent of Europe, moreover, German industry was famous for its productive efficiency.

Likewise in this country the industries most often criticized for cartel practices, namely the chemical and electrical industries, are conspicuous for their research activity. Unfortunately for this line of reasoning, it does not follow that any less research would be carried on if conditions within these industries were fully competitive; the necessity for research is largely inherent in the industries, and research is probably as active in those branches where competition is keen as where it is not. It is conceivable also that by reducing the element of risk cartels may help to overcome one of the obstacles to new investment, and that this is favorable to the introduction of new and better products as well as to the maintenance of employment.

ECONOMIC INSTABILITY

A well-known explanation of the origin of business fluctuations attributes them to a tendency for new discoveries to be concentrated in short periods of time. It is not im-

[13] Cf. F. B. Garver, "Cartels, Combinations and the Public Interest," *Journal of Farm Economics*, November 1944, pp. 627-28.

possible that cartels would administer the introduction of new methods and products in a way that would reduce the concentration of innovations. Such a policy would be in accord with the emphasis cartels customarily place on stability. To the extent that cartels served to regulate more evenly the rate of innovation, their influence upon business fluctuations would resemble that of the planning of public works by governmental bodies.

The principal way in which cartels are alleged to influence the stability of business conditions is through their effect on prices. In a period of declining business, controlled prices are prevented from declining and thereby get out of line with prices of uncartelized products. In addition to diverting purchasing power, increasing the pressure on more flexible prices and dislocating established price relationships, the maintenance of relatively high prices in the cartelized industry is said to lead to a further decline in production and to result in greater unemployment.[14]

There seems to be no doubt that in general cartelized prices fluctuate less than uncartelized prices.[15] This difference is attributable only in part, however, to the existence of cartels. Some products lend themselves to cartelization and others do not. It is quite possible that the prices of products which are subject to cartels would vary less than other prices even if there were no attempt at cartelization. Relative stability of prices, as the auto-

[14] See Pribram, *op. cit.*, pp. 232-33, and passim, who speaks of the tendency of "cartels to stabilize prices as against stabilization of production and employment"; also Karl Pribram, "Controlled competition and the Organization of American Industry," *Quarterly Journal of Economics*, May 1935, p. 389.

[15] Pribram, *Cartels*, pp. 232 ff.

mobile industry illustrates, is not dependent upon cartel organization.

As advocates of cartels have been quick to point out, if the difficulty lies in the disparity between flexible and rigid prices, the cure might be sought not in making rigid prices flexible but in stabilizing the flexible prices, possibly through broadening the field of cartelization.[16] To some extent cartelization may be the result of price rigidity rather than the other way around. The movement toward cartelization in England in recent decades may have been stimulated by the expansion of trade unionism, increased trade barriers at home and abroad, higher taxes and other factors making for economic rigidity.[17] Or the whole trend toward control may be of a piece, with the spread of cartels appearing both as cause and effect. If it is an exaggeration to suggest that cartelization is largely a defense against other elements of rigidity, it would be no less inaccurate to suppose that by abolishing cartels we would achieve a truly flexible economic system.

The preoccupation with price flexibility is itself a reflection of a particular interpretation of economic theory.[18] Since the early 1930's there has been a tendency to place great stress upon maintenance of total monetary outlay as a means of avoiding the basic causes of depression and general price dislocation. The result has been to reduce

[16] See Bruno Burn, *op. cit.*, pp. 186-88.

[17] See Lucas, *op. cit.*, pp. 259-69.

[18] Professor Lucas has observed that the case as usually presented exaggerates the effect of control on prices and of the stability of individual prices on industrial stability (*op. cit.*, p. 363). Even when harmonious price relationships are sought, the effectiveness of antitrust legislation or public regulation in insuring these relationships may still be questioned. Cf. J. K. Galbraith, "Monopoly Power and Price Rigidities," *Quarterly Journal of Economics*, May 1936, p. 474.

the relative importance attached to the behavior of individual prices. Moreover, the claim that cartels increase the stability of the prices of their products cuts two ways. The possibility that cartel practices may contribute to greater stability in some industries is balanced by the possibility mentioned above that by that very fact they may accentuate the instability of other industries. What their effect may be on stability depends partly on how one chooses to define stability, whether in terms of prices, profits, output or employment. If a cartel succeeded in fixing prices by the monopolistic regulation of output, its experience might be cited to demonstrate, on the basis of prices, that cartels promote stability or, on the basis of output, that they have exactly the opposite effect.

To advocate cartelization for the sake of reducing cyclical instability represents a particularist approach to what is a problem of the most generalized character. At the present time, increasing reliance is being placed upon an over-all attack on the problem of the business cycle, i.e., through measures to sustain total effective demand, such as fiscal policies and public works. Any tendency for cartels to stabilize the price of individual commodities is more likely to impede than to assist programs designed to maintain business activity by stabilizing total monetary outlay. And it is simply not in the nature of cartels to promote general equilibrium by facilitating price flexibility.

OVERCAPACITY AND CUTTHROAT COMPETITION

The primary function of price is to assist in adjusting the scale of production of particular goods and services to the level of production of other goods and services.

Price is an essential part of the mechanism for automatically accommodating the production of goods and services to the wishes of the consuming public. Where freely competitive prices fail to discharge their function satisfactorily, the question arises of whether cartels, or some other noncompetitive device, might not do the job better.

In a situation of over-production the ideal, under competitive conditions, is that prices should decline to such a point that excess capacity is eliminated and only the desired number of most efficient producers are left in operation. The losses that would befall certain producers are part of the process of natural selection that is expected to result in the survival of the fittest: the saying that "competition is the life of trade" has as its less familiar complement, "but it is the death of the individual."

Competition may fail for a time, however, to eliminate excess capacity. Through failure and re-organization producers may continue in operation, though at a rate of return that does not cover long-run costs. This is the market's way of salvaging a part of what might otherwise be wasted as a result of over-investment. The result is that in industries with heavy overhead, the process of adjustment works slowly rather than at once. Nor is the selective process altogether perfect; it is possible that greater financial resources may allow producers who are technically less efficient to survive when other producers are forced out.

The most serious fault of this mechanism of selective adjustment under competition is that an over-supply may force prices considerably below the long-run equilibrium rate. Efficient producers whose capacity is only temporarily in excess may then be eliminated along with pro-

ducers who are genuinely superfluous. The sacrifice of capital equipment and technical skills which later must be replaced constitute an economic loss to society.

In a smoothly running economy this difficulty would seldom arise, for the simple reason that price adjustments would ordinarily have prevented the emergence of the condition of over-supply which gives rise to the problem of eliminating overcapacity. In an economy that has been distorted by the effects of a great war, however, supply conditions are highly abnormal. Is it reasonable to expect that these abnormalities can be automatically corrected, except with great and needless hardship, by the free movement of prices? Is it sensible to shift suddenly from a situation where prices and production were subject to a large measure of control to one where they are free?

Even the most ardent believer in a free price economy must suffer qualms at the prospect of an abrupt transition from controlled to free conditions, and surely his doubts can only be increased by contemplating the practical problems that exist in lines such as rubber, aluminum, aircraft production, shipping and many types of chemicals with the decline in military demands. Reliance on the play of market forces is all very well when they have been allowed to operate freely in the past. It is very different when the economy has been thrown out of balance and there is a question of achieving a *modus vivendi* which will avoid needless hardship. The remedy for excessive administrative control is not the sudden lifting of all the controls introduced to meet emergency conditions. Decontrol is a far more delicate operation than the establishment of control.

To recognize that a peculiarly acute problem results

from the dislocations caused by war is not, of course, to acknowledge that cartels, or any approach to them, provide an acceptable solution. However, whether cartelization is the best solution or not, the problem posed by the advocates of cartels is not to be denied. If the cartel solution fails to resolve all reasonable doubts, so also does the easy prescription that readjustment following a period of major economic dislocation be left to the undirected play of competition.

Interference with the stern selective process of survival of the fittest on which competition relies may allow high cost producers to continue in operation while low cost production is abandoned or held in abeyance. This has been demonstrated again and again in the experience of European cartels. It has occasionally happened, indeed, that the maintenance of a high price by cartels has led to the entry of new producers into the industry and thereby aggravated the very condition of overcapacity which the introduction of cartelization was expected to regulate in an orderly manner.

Cartels would doubtless avoid some of the evils of free competition; but it is equally true that they would bring serious dangers of their own. Attempts to avoid over-elimination of productive capacity incur the risk of eliminating too little, with the result that the condition of over-supply becomes chronic. A condition of overcapacity is not necessarily, of course, the consequence of cartels; a cartel may be organized because overcapacity already exists and cartelization offers a means of avoiding a destructive price war. What may, however, be attributed to cartels is an undeniable tendency to perpetuate a condition of overcapacity by hindering those movements of supply and price

which would bring about the elimination of high cost producers.

Neither competition nor cartelization will permit society to escape the burden of overcapacity once it has developed. They simply represent different means of dealing with the condition of overcapacity, the one through a painful process of price decline and bankruptcy which helps to correct the situation, and the other through restricted production and maintenance of price which may allow overcapacity to continue. Either policy may be defended, depending upon what conditions are assumed and what ends are desired. What is not defensible is to mistake the more stable conditions under cartels for a solution of the fundamental problem, or to suppose that the failures and bankruptcies which occur under competition are always socially harmful.

COMPETITION IN A FREE ECONOMY

The ultimate motivating force in our economic order, notwithstanding the fact that society has seen fit to impose certain limitations on its operation, is individual self-interest. But "enlightened selfishness" requires the selfishness of others as a check upon its performance. That is why freedom to earn profits is one thing under competition and quite another under monopoly. Profits are an acceptable regulator of economic activity only if they are allowed to regulate, i.e., only if the individual is relatively free. The first requirement of a system of free enterprise is that it be free.[19]

[19] "Free private enterprise is either competitive or it is not free."—M. W. Watkins, *Proceedings*, p. 58. It may also be ventured that more enterprise is likely to be exhibited where the pressure of competition is free to spur businessmen on.

Either free competition or administration by cartels is admittedly an imperfect means of regulating economic activity. The question is not whether cartelization might ameliorate some of the undesirable effects of free competition; it is whether, on balance, cartels would bring greater evils than they removed. The reason we have a cartel problem and the basic difficulty in formulating a policy is precisely that any course we choose has its own peculiar advantages and dangers. But the great merit of the competitive guidance of production is that the costs of competition are incurred not without purpose. Competition works, however clumsily, to select and allocate, stimulate and eliminate, on the basis of efficiency and what the public wants. The interests it serves, even when it serves them imperfectly, are the collective interests of the community as a whole and not of a particular group.

"It is not—or at least not wholly—a question of ethics, of the moral priority of the consumer and the producer. It is a question of economic efficiency. Competition reconciles the individual producer's interest with the community's interest. In seeking to enlarge his own slice of cake, the producer is compelled to assist in enlarging the whole cake. But in a society of monopolies, each individual would be doing his best to shrink the size of the cake. It is the state's duty to prevent such an economic suicide pact among its citizens." [20]

The conclusion is unavoidable that in an economic society such as that of the United States the general rule should be to discourage cartels. Either we believe in competition and economic democracy or we do not. If we do,

[20] *The Economist,* June 1944, p. 835.

we cannot, as a general policy, endorse cartels, which are neither competitive nor democratic.

Authorization to enter cartel agreements is indicated, if at all, only as an exception to an accepted rule, and then only because of very special circumstances. A competitive economy requires that there should be competition. Undue restraints, whether they originate from the side of business or the government, are more than inconsistent with the spirit of a competitive economy; they are inimical to its effective operation. The proliferation of public or private restraints upon competition signifies, if carried too far, the destruction of a free economy. But long before freedom has entirely disappeared they will have imposed a strait-jacket, or more probably a jangling of counter-pulls, that renders a tolerable functioning of the economy impossible.

Chapter III

ARE CARTELS A MENACE TO PEACE AND SECURITY?

THE MOST familiar argument against international cartels and the one which has the greatest weight of official support behind it is that they are a menace to world peace in general and to United States security in particular. At the same time, however, it is perhaps the weakest ground on which to attack cartels.

CARTELS AND PEACE

Senator Kilgore, whose work as chairman of important sub-committees investigating war activities clearly gave him the right to speak with authority, has a short and specific explanation of the origin of the second world war. "Germany, under the Nazi set-up," he said, "built up a great series of industrial monopolies in steel, rubber, coal and other materials. The monopolies soon got control of Germany, brought Hitler to power and forced virtually the whole world into war." [1] Mr. Francis Biddle, while Attorney General, declared, after analyzing a number of German cartels, that "a peace with Germany which leaves these companies intact will be a peace to insure another war against us." [2]

Here we have it, on highest official authority, that cartels were the cause of the second world war and may be the cause of another war. It is, therefore, surprising to

[1] *The New York Times*, October 2, 1944.
[2] *The New York Times*, August 30, 1944.

discover that in a recent and compendious study of war [3] the word "cartel" is not listed in the index although there are references to "autarchy," "economic warfare," "tariff," and so on. Nor is the term "cartel" to be found under "causes of war," despite scores of references running from "economic" to "sexual prestige."

There are fads and fashions in explaining the origin of wars, and emphasis on cartels happens to be one of the current modes in popular discussions of the influences contributing to war. In the 1920's, exactly the opposite argument was widely accepted: the origin of the first world war was explained in terms not of cartelization but of competition. Thus one of the best known texts on corporate policies, which was by no means friendly toward monopolistic practices, declared that international cartels "may serve to promote better understanding among the businessmen of different countries and to substitute cooperation for the hostility-breeding competition for markets that was one of the factors which brought about the World War." [4]

The division of loyalties and interests that may result from participation in cartels cannot be accepted as a serious objection to them. Membership in a cartel is inherently no more incompatible with loyalty to one's country than is ownership of the bonds of some foreign government. Either would give the individual an economic interest that might cut across the lines of political allegiance. It can be argued with equal logic that cartels may help to overcome narrow nationalism, create a community of

[3] Quincy Wright, *A Study of War*, Chicago, 1942, 2 vols., 1552 pp.
[4] H. R. Seager and C. A. Gulick, *Trust and Corporation Problems*, New York, 1929, p. 627.

interests and foster a spirit of international cooperation conducive to the preservation of peace. It is a curious fact that most of the political arguments currently advanced against cartels can be reversed to support the case for allowing American business to participate in cartels.

SHORTAGES OF VITAL WAR MATERIALS

International cartels have been charged with responsibility for the shortages which developed, during the early stages of preparing for war, in the supply of raw materials vital to national defense. "The conduct of cartels before and during this war has been one of the tragic pages of our history. The shortages of aluminum and magnesium resulting from cartel restrictions forced us to strip the kitchens of America and scar our public squares with scrap piles. The scarcity of rubber is a never-ceasing threat to our productive effort. . . . Almost wherever there was a cartel there was a shortage." [5]

Without denying the high qualifications of the author of this observation, it could likewise be said that "almost wherever" there was not a cartel there was also a shortage. Indeed, the list of commodities that were rationed during the war consists chiefly of items in which cartelization had never been alleged to exist. Wartime shortages were almost wholly the result of expansion in demand and not of prior restrictions on supply. The shortage of aluminum arose primarily because one bomber requires material equal to the yearly demand of a hundred thousand housewives. Rubber was scarce both because of the conquest of pro-

[5] Wendell Berge, *Cartels, Challenge to a Free World*, Washington, 1944, p. 11.

ducing areas and because a single tank may require more rubber than several dozen automobiles.

It happens that a large part of the production of certain vital raw materials, notably rubber, tin and quinine, was concentrated in a relatively small area in the East Indies. Even apart from the expansion in demand, the speed of the Japanese conquest of the regions where production was concentrated would have made these commodities scarce, whether or not they had ever been subjected to restrictive controls. In addition, the situation was aggravated and generalized by the pressure on shipping facilities resulting from wartime conditions.

Germany is said to have deliberately used cartel connections to weaken the aluminum industry in other countries, particularly in the countries with whom war seemed probable. "The improved cartel device was used both to invade and to occupy strategic sectors in the economies of the disunited nations. The cartel was I. G. Farben's formula for conquest." [6]

At most, however, German cartels were only one cog in the Nazi military machine. At a time when Germany was determined to make preparation for war the most important business of the state and other countries were not, a greater expansion of war-vital industries would have occurred in Germany than in other countries even in the absence of cartels. Shortages are largely a relative matter; if other countries had produced more than they did of these strategic goods, Germany would have produced still more. Granted that she had decided to equip

[6] Joseph Borkin and Charles A. Welsh, *Germany's Master Plan*, New York, 1942, p. 13. See also Thurman Arnold's Introduction, pp. xiv-xv; also Edwards Report, p. 58.

herself for war, Germany would presumably have produced whatever was thought to be necessary to provide military superiority. It is scarcely credible that the absence of cartels would have made the process so expensive to Germany that the attempt to achieve military superiority would have been abandoned.

We cannot be sure precisely what would have been the extent of German preparation for war in the absence of cartel arrangements with American producers, and it is equally true that we cannot tell just what our own preparedness would have been under the same assumption. Cartel agreements, as will be seen later, frequently contained provisions for excluding imports of particular producers from the United States market. To the extent that these prohibitions applied to strategic materials such as aluminum, tungsten carbide, drugs and chemicals, their net effect may even have been to strengthen our military preparedness by increasing our self-sufficiency in these materials.[7]

CARTELS AND NATIONAL DEFENSE

The case against cartels on grounds of national security turns chiefly on the use made of them by Germany as instruments of espionage and sabotage in the preparation for and the prosecution of the war. Cartel connections are said to have provided a means of acquiring and con-

[7] From the documents cited by the Department of Justice, it seems clear that Krupp desired to see an expansion of the production of tungsten carbide in the United States following the conclusion of cartel arrangements. In the early stages of negotiations over the agreement Krupp reserved the right to license other producers if sales by General Electric failed to reach a certain amount by a stipulated time.—Kilgore Committee, Scientific and Technical Mobilization, Part IV, pp. 237-39.

veying to the German military authorities information of great value to them, of obstructing the production of strategic materials in this country and of spreading propaganda in third countries.

Some of the accounts of the political activities of international business concerns are among the most colorful of cartel atrocity tales. In a letter to Secretary Hull on the subject of cartels President Roosevelt remarked that the reports of cartel activities read like a detective story. The question that needs to be raised is not whether the stories are true. With some reservations for direction of emphasis and completeness of disclosure, their truth may be conceded. What needs to be considered is whether this evidence, fully detailed and followed through in its logical implications, supports the conclusion that American business should be precluded from future participation in international cartel arrangements.

To take a particularly flagrant example, during the 1930's the American Bosch Corporation came into possession of information based on experimental work of the United States Navy and Signal Corps. This information was supplied to the company, which was presumed to be completely reliable, on a confidential basis preparatory to the submission of bids for war contracts. However, the knowledge was transmitted to the parent company in Germany which owned a majority of the stock in American Bosch. It shortly found its way into the hands of the German General Staff and became the basis of the radio communication system used by the German army during the war.[8] Secret United States military information also was

[8] Edwards Report, pp. 53 ff.

given to Germany by Bausch and Lomb both before and after Hitler came to power.[9] The Germans are said to have obtained from American concerns patents and technical knowledge of great value for military purposes, including among others our process for making synthetic rubber.

The objection that cartels may be the means of conveying essential information cuts two ways. If it is possible for this country to lose it is also possible for this country to gain strategic information through the cartel activities of its citizens. In 1927 the Standard Oil Company of New Jersey bought from I. G. Farben-Industrie the American rights to the German oil-hydrogenation process. The information thus obtained became the basis of extensive research carried on in a different direction from that to which the process had theretofore been applied. This research was conducted in complete secrecy except for the Ordnance Division of the United States War Department. The result of the investigation was discovery of a new method of producing toluol, principal ingredient for TNT, which made it possible for this country by 1941 to produce explosives at one-fifth of the cost and on a scale equal to any demand.[10]

Spokesmen for American businesses participating in cartel agreements maintained that at the lowest estimate this country was spared years of research and developmental

[9] Extensive quotations of the most compromising character from correspondence passing between Bausch and Lomb in America and Carl Zeiss and August Lomb in Germany are presented in the statement of Wendell Berge before the Subcommittee on War Mobilization, Committee on Military Affairs of the Senate of the United States. Press Release, September 7, 1944.

[10] *Eighteen Dates with Destiny*, published by The Standard Oil Company (New Jersey), 1944.

work as a result of the information obtained from the Germans. The President of the Standard Oil Company of New Jersey, after testifying that his company had received technical knowledge from Germany which was vital to the production of a number of products of great military significance,[11] remarked, "Gentlemen, what do you think Hitler would give today to be able to keep America from using these discoveries and processes?" [12]

According to testimony before the Kilgore Committee, valuable information on the production of 100-octane gasoline was made available to the Japanese, Russians and British by an American research institute, the Universal Oil Products Company.[13] While this information may be presumed to have been of great benefit to the Japanese, it is not clear but that our military gain may have equaled or even exceeded our military loss because of the advantage derived by our subsequent allies, Russia and Great Britain. The claim has been advanced, in fact, that an important reason for the successful outcome of the Battle of Britain was the superior aviation gasoline the British were able to produce by methods acquired through cartel connections.

If it is true, as is by no means always admitted,[14] that

[11] Including, in addition to toluol, 100-octane gasoline, ammonia, paratone (for hydraulic and recoil oils), paraflow (for freezeproof motor oils), and rubber and rubber substitutes.

[12] Kilgore Committee, Hearings on Scientific and Technical Mobilization, Part IV, p. 688.

[13] Testimony of James W. Martin before the Subcommittee on War Mobilization, Committee on Military Affairs of the Senate of the United States. Press Release, September 9, 1944.

[14] Business Week for September 16, 1944, reports that "American chemical manufacturers who had prewar dealings with foreign technicians hold that the 'know-how' we got from the Germans, at least, exceeded anything the Germans got from us."

the United States lost more than was gained by this sort of exchange of technical knowledge, it must be attributed, in part at least, to our relative inexperience in the ways of cartels. Neither the American government nor American businessmen were fully conscious of the designs of the Nazi government nor of the place cartels occupied in those designs. To the extent that the partnership of the National Socialist government with German business gave the Germans an advantage over this country in getting ready for war, the fault may be said to lie with the United States government quite as much as with American businessmen for having been blind to the dangers of such an alliance.

Evidence to support the view that the government as well as business was negligent in dealing with strategic technical information is drawn from the Baruch Report on rubber. It is alleged that soon after Pearl Harbor the Russian government offered to supply full information on the so-called "Russian formula" for the manufacture of synthetic rubber. At the time of the preparation of the Baruch report months later, no reply had been received from the American government. While it was suggested that the adaptability of the formula was in doubt, "no single agency had apparently taken responsibility to find out if that was true or not." [15]

Notwithstanding certain strategic benefits the United States seems to have derived from cartel connections, it is probably true that Germany came off better than other countries in a political and military way as a result of the

[15] Testimony of Dr. H. C. Lacy, Chief of the Foreign Information Section of the Office of Price Administration, Kilgore Committee, Hearings on Technological Mobilization, Vol. I, p. 32.

activities of international cartels. Indeed, it could hardly have been otherwise. Cartels were more highly developed in Germany and the control of the government over the actions of its nationals was far more pervasive and firm than in the democratic countries. The German government had a clearer idea than the governments of the democracies of what it wanted and was more ruthless in attaining its ends. After Hitler came to power it was a criminal offense to give technical information to foreign countries without the approval of a government agency.[16] Moreover, the rigid control of foreign exchange operations provided the German government with a powerful instrument for observing and influencing foreign as well as domestic business. In short, it was a situation where "one well-organized industry and its country with an absolutely clear and determined policy and aim met an industry and a country without such definite and determined aim working in accordance with the principles of liberal economy." [17]

CARTEL ACTIVITIES IN THIRD COUNTRIES

Cartels are also alleged to have undermined the efforts of the United States to strengthen its political position in third countries. "Latin America was turned over by private cartels as a colony to hostile foreign interests. By giving German industry virtually a free hand in Latin America and by agreeing not to compete, American cartelists made possible the creation of a German sphere of influence. Nazi propaganda, espionage, and subversive activities all

[16] Kilgore Committee, Scientific and Technical Mobilization, Part I, p. 92.

[17] *Ibid.*, Part IV, pp. 443-44.

stem directly from this unhampered German penetration." [18]

The question naturally arises of how the American negotiators were compensated for the free hand they gave the Germans in Latin America. If the *quid pro quo* was a promise to stay out of the American market, the cartel agreements must, presumably, be credited with having reduced the direct penetration of the United States by German industry. To that extent they may have protected this country against outposts of German influence which would have offered convenient avenues of espionage and sabotage within the United States. German sales representatives, distributing agencies and branch factories, such as might otherwise have been established in this market, would seem even better adapted than cartels to facilitate undercover political activities of the sort now laid at the door of cartels.

An international cartel, the Sterling Products Company, in which British and American enterprises were represented, is alleged to have exerted a pro-Axis influence in Latin America as late as 1941 through directing advertising away from newspapers hostile, and toward newspapers favorable, to the Axis.[19] Whatever the merits of this particular case may be, it is obvious that anyone who has interests, as an investor or otherwise, in a foreign company may expect, at any time when the two countries are at war, to find the business in which he is interested working to bring about the downfall of his own country. To criticize cartels because they may be the agency for such a division of loyalty is, by implication, to condemn

[18] Berge, *op. cit.*, p. 12, and see Edwards Report, pp. 53 ff.
[19] Edwards Report, p. 54.

investment and other economic relations in a great many countries of the world.

The political consequences of the activities of cartels in third countries are by no means confined to matters relating directly to war. Cartels in which American companies participated are said to have interfered with the industrial development of parts of the world which the member companies were disposed to look upon as colonial markets. Instances have been cited, though they are by no means confined to undeveloped countries, where established companies have hindered or prevented the growth of local enterprises which might have competed with their export trade.[20]

The inconsistency of American businessmen being party to such practices at a time when the American government is committed to the Good Neighbor Policy is apparent. Apart from the positive injury that conceivably could be done another country in this way, ill-will might be generated which would interfere with the improvement of international political relations.

The alleged exploitation of foreign countries by powerful business interests is an ancient problem. It has long been attacked under such names as "economic imperialism" and "dollar diplomacy." Whether or not it was as common an occurrence as is sometimes implied, it is in no sense a problem peculiar to cartels. To the extent that abuses of this sort have occurred under cartels, they doubtless call for correction; but the problem cannot be solved merely by getting rid of cartels, nor is the cartel issue to be decided in terms of a phenomenon which is likewise common to other forms of business organization.

[20] Edwards Report, p. 47.

TOTALITARIANISM AND DEMOCRACY

The use of cartels as a political instrument is associated, in the eyes of most Americans, with totalitarian forms of government. This attitude exists primarily because we tend to identify cartels with Germany, and particularly with Germany under the Nazis. It may also be influenced by the belief, conscious or unconscious, that cartels can be turned to national advantage by a dictatorship but not by a democracy.

A dictatorship, and more especially a dictatorship of the ruthless type, would find it considerably simpler than a democratic government to subordinate business enterprises, whether cartelized or not, to the attainment of political objectives. A dictatorship has wider powers than a democratic government and is ordinarily more determined in its methods. The freedom of individuals and groups is likely to constitute little or no obstacle to the exercise of governmental authority. A totalitarian government usually has a clearer conception than a democracy of what it wants and how it is prepared to get what it wants. And it is far easier for such a government to pursue its designs in secrecy.

Considerations such as these fall far short of establishing a conclusive case against international cartels. The differences mentioned apply to the possible adaptation of all types of business—indeed, of all aspects of civilian life—to the pursuit of political ends. The danger of a reckless dictatorship employing devious tactics is not to be overcome by abolishing cartels. Their abolition would accomplish little toward either preventing such tactics or eliminating the dangers resulting from the irresponsibility of

dictators. The dangers cannot be removed by any such indirect means.

We shall hardly be able to prevent other countries, even if we would, from exercising influence over business enterprises in their countries, including influence which has a political focus. To deprive our own government of recourse to the methods available to other countries, if they are as effective as is intimated, would give a needless advantage to potential enemies. If cartels were certain to be a powerful political instrument, this fact would furnish grounds for strengthening American businessmen in their dealings abroad, even to the extent of giving cartel agreements the encouragement and support of the government, in the hope that in the future they might serve the interests of this country as successfully as German business is said to have served the wishes of the Nazi government.

Actually the political aspects of the cartel problem are neither as significant nor as peculiar to cartels as is generally supposed. If cartels were a menace to our security under the Nazis, the primary reason lay in the government which was in control, and not in cartels themselves. The threat afforded by cartels was common, as was demonstrated again and again, to all institutions and activities which were under the dominance of the Nazis.

Whatever one may think of the desirability of cartels as a form of business organization, their political consequences must be viewed in reasonable perspective. Switzerland has been called the "mother of cartels," yet Switzerland remains firmly democratic and apparently cartels are regarded as presenting no threat to national security. Likewise in England, where cartels are under attack, they

are being criticized as an economic, but not as a political, liability. The evidence of the democracies where cartels are allowed to exist strengthens the conclusion that the political hazard of cartels has been greatly exaggerated. Surely an alert democracy should be able to devise means of safeguarding itself against whatever risks the international activities of cartels or of other forms of business organization may entail. The airing of the political actions engaged in by cartels before and during the war has served the useful purpose of demonstrating the necessity of remaining alert at all times to the possibility of such undercover tactics.

THE QUESTION OF RESPONSIBILITY

The foreign office of any government must be master in its own house. In order for the State Department to remain in control of foreign policy, the international activities of our businessmen should be subject to some degree of regulation and supervision. This is true whether or not they are organized in cartels, but the existence of cartels may accentuate the problem because of their greater scope and wider interrelations. As a specific illustration of the way foreign policies may be overridden by monopolistic arrangements, it is said that the reduction in the duty on aluminum by the trade agreement with Canada in 1939 was nullified when Aluminium Ltd. of Canada deliberately refrained from making any sales in the United States. This policy was attributed to the close relationship, through common ownership of stock, between the aluminum industries of the United States and Canada.[21]

[21] Edwards Report, p. 44. Stock in Aluminium Ltd. is controlled by principal stockholders in the Aluminum Company of America. The Canadian company is a member of the world aluminum cartel under

Even apart from the extent to which business enterprises may have usurped foreign political functions, the operations of American business abroad are and will remain an important datum in international affairs. Since they cannot logically be left outside the purview of the State Department, it is essential that adequate machinery be provided for observing, and to some extent supervising, the foreign activities of American business. The province of such an agency should include, but it cannot be limited to, cartel arrangements in which American business may be involved.

If businessmen, and more particularly those participating in international cartels, are to be criticized for having complicated the foreign policy of the United States, surely the government is by no means free of responsibility for having allowed a situation to develop where such complications were possible. With the wisdom of hindsight we can see that it was unfortunate for American businessmen to continue to ship oil, scrap iron and other war materials to Japan. But was it the duty of business or of the State Department and the military authorities to recognize this danger? What if businessmen had decided to ship no more war materials to Japan? Would not such unofficial economic sanctions have been condemned as a major interference in the foreign policy of the country? And if the action had been taken jointly by businessmen, can it be doubted that the Department of Justice would have criticized them for a clear case of restraint of trade in violation of the Sherman Act?

which no producer outside the United States is allowed to sell in the United States. The cartel assigns quotas outside the United States but avoids any allocation in the United States. Cf. Donald H. Wallace, *Market Control in the Aluminum Industry*, Cambridge, 1937, pp. 75-76.

The actions of any group can be judged only in the light of knowledge existing at the time. Businessmen are not to be condemned for having been no wiser or more statesmanlike than the State Department itself. The chief lesson to be learned from this episode and from the other incidents cited is that economic policy is an inevitable part of our foreign policy. There is a demonstrated need for some permanent body within the government whose duty would be to keep fully informed concerning the military significance of the policies and activities of our citizens—and also of governmental departments.

CONCLUSION

The attitude of the public toward cartels is nowhere more strongly influenced by current conditions than in regard to their international political significance. The reason the security aspects of the cartel problem bulk so large today is because we have so recently been engaged in a long and bitter war.

The conception of a cartel as a supra-national entity, devoid of any national loyalties or patriotic impulses, has been strengthened by the fact that cartel agreements sometimes contain provision for their suspension in time of war and their subsequent resumption.[22] It is only in time of war or soon thereafter that such a provision is likely to seem particularly out of the ordinary. A few years hence many of us will doubtless wonder, if we stop to think about it at all, why it should have seemed so heinous to assume that business relations broken by the war would be patched up again when peace was restored.

The political aspects of international cartels, notwith-

[22] Edwards Report, p. 73.

standing the prominence this phase of the problem has been given, provide the weakest ground on which to judge cartels. It is not that the political activities of cartels have been unimportant; it is rather that they lead to no clear answer to the question of what to do about cartels. The same considerations on which cartels are condemned can often be reversed to defend them; the evidence presented in criticizing the use made of cartels for political and military purposes is frequently one-sided and incomplete; and very often the fault lies as much or more with the State Department and our military leaders as with American businessmen who participated in cartels.

International cartels have unquestionably been made an instrument for war. It may be presumed that they were most effective as a military weapon when in the hands of countries which were awake to their possibilities and made efficient use of them. The same is true of airplanes, tanks, submarines and atomic power. Whether, like airplanes, they have significant peacetime uses or, like submarines, they have not, may, perhaps, be a debatable question. But to regard the circumstance that they have been employed for military ends as a reason why international cartels should henceforth be banned is to find an equally good reason for abolishing airplanes, submarines, and the use of atomic energy.

The fact that international cartels may be subverted to the prosecution of political, including military, objectives is irrelevant to the main issue. The same objection can be —and has been—raised to almost every other international activity that can be mentioned, including foreign educational institutions, foreign missionary endeavor, travel abroad and any sort of business activity that crosses fron-

tiers. The logical conclusion of this line of argument would be the prohibition of all commercial, industrial, social or cultural intercourse between countries; for the same difficulty could arise out of anything that serves as a reason for the citizens of one country to find themselves in another country. The cure is not to prohibit these exchanges but to provide whatever safeguards seem feasible and desirable, and to recognize and prepare for the possibility of abuse.

Nothing that is said here is intended to suggest endorsement of international cartels. But the case against cartels, if it is to stand, must be based on firmer grounds than these.

Chapter IV

ARE CARTELS ESSENTIAL TO AMERICAN EXPORT TRADE?

OF ALL the arguments advanced in favor of cartelization, the one that carries greatest weight with businessmen and the general public is that American exporters will be under a serious handicap unless they are free to adopt the policies followed by their foreign competitors.[1]

WAVE OF THE FUTURE

Milo Perkins, former head of the Board of Economic Warfare, advanced this contention with particular force by saying that "we Americans have got to operate in the world as it is today and not in the fairyland of our own oratory. The wider the gap between our preaching and our practice, the sillier we look to other nations. It's time for us to make our foreign trade policy fit the realities of an era which has already gone a long way toward cartelization." [2]

"No American firm," according to Mr. Perkins, "is strong enough to buck such arrangements by itself. Either it must have the support of the State Department in its insistence on doing business competitively, or it must be permitted, with diplomatic backing, to do business on a cartel basis. . . . The only other alternative is to pull out —and our need for foreign markets won't allow that to

[1] Cf. *Memorandum on Regulatory Measures Affecting American Foreign Trade,* New York, National Foreign Trade Council, Inc., p. 109.

[2] "Cartels: What Shall We Do About Them?" *Harper's,* November 1944, p. 575.

happen very often.[3] . . . With our major foreign competitors in world markets already operating as closed economies—or moving rapidly in that direction—we are likely to find free competition in many fields as obsolete after the war as a Model T Ford." [4]

This is the wave of the future all over again. It is wave-of-the-future even to the respectability and excellent intentions of those who advance the contention. And it is no less false and dangerous. The principal flaw in the argument is that it completely underestimates the effect which the policies we adopt are likely to have on the conditions that will prevail in foreign trade after the war. For it is certain that the policies this country follows will greatly influence, even though they do not entirely govern, the structure of legal and commercial organization which our businessmen will encounter in their operations abroad. The surest way to guarantee that there will be a cartelized world is to embrace cartels ourselves.

The policy we follow toward cartels may be expected to influence the course of cartelization in a variety of ways. Not only will it affect the freedom and scope of American participation in cartels, it is certain to have an important bearing upon the direction of the cartel policies adopted by foreign governments. Most important of all, in cases where participation by American companies is essential to the success of cartelization it will determine whether cartels will or will not exist.

No cartel can expect to succeed unless it controls a large part of the market where it operates. In a good many lines American producers are such an important factor in

[3] *Ibid.*, p. 573.
[4] *Ibid.*, p. 578.

the market that unless they participate there is likely to be no cartel. Without much doubt this is one reason for the eagerness of many foreign enterprises to secure American participation in cartels. It also suggests the need of caution in concluding that cartelization is necessary in order to enable American producers to do business abroad.

The argument that American businessmen should be allowed to join international cartels because they are inevitable is highly persuasive if the major premise is accepted. It carries the popular appeal that always goes with the claim of being brutally realistic. But with respect at least to the extent of possible cartelization, the claim of realism is entirely unwarranted; for cartel practices can attain full stature only if this government grants them official approval, while vigorous opposition by the United States government will restrain them even if it does not eliminate them.

The only self-respecting grounds for adopting a policy favorable to cartels would be that we believe that international cartels offer more advantages than disadvantages, that we are glad to throw the great weight of our leadership and influence on the side of this form of business enterprise, and that we look forward with confidence and satisfaction to a world in which cartels have scope and freedom to develop. By the same token, if we hold the opposite convictions, the only defensible policy is to resist cartels with the full vigor of those convictions.

To be governed by the line of our own reasoned beliefs is not to forget that we live in a world of reality. It is rather to remember that the real world is one in which, in fact, we very decidedly do live, and one whose character is, therefore, bound to be substantially influenced by the

manner of our living. There is neither realism nor consistency in maintaining that we are part of the world and then proceeding as though the policies of the rest of the world were independent of the cartel policies we ourselves adopt.

A fatalistic, defeatist attitude toward cartels—a view that we must have cartels because foreign countries allow them —is as hard to justify on grounds of expediency as it is on grounds of principle. Cartelization, and all that it implies, is not something foreigners do to us. Primarily it is something we do to ourselves.

CARTELS AND FOREIGN LAWS

American businesses selling abroad may find themselves obliged, it is alleged, to transgress the laws either of a foreign country or of the United States. The president of the Standard Oil Company of New Jersey expressed an exporter's point of view on this issue:

> American businessmen want to obey the law and they want to increase foreign trade. That is what our Government also apparently wants. The only way both can be done is for businessmen to be assured that when they obey the laws and customs of other lands in their dealings there, they are not breaking the laws of the United States. . . .
>
> At present, the activities of American business in the foreign field may be subject to two sets of laws: the Anti-Trust Acts so far as the United States is concerned and the Trade Laws of the country directly affected by the business. These two sets of laws often are diametrically opposed to one another both in their underlying philosophy and in their specific provisions.[5]

[5] *Stenographic Report of the Annual Meeting of the Standard Oil Company (New Jersey), June 6, 1944,* pp. 36-37, and *Statement before*

Former Ambassador James W. Gerard voiced a stockholder's opinion when he asked:

> As long as other countries have these cartels, as long as other governments insist upon them, why should we cramp our style by instructing our officers not to join for our benefit, in these cartels? [6]

The nature of the difficulties experienced by American exporters because of the antitrust laws of the United States is usually left in these vague and general terms. It is apparently assumed to be self-evident that the businessman would be under an extreme handicap if his competitors were allowed to do certain things which are forbidden to him. But when one attempts to add flesh to the bare bones of this assumption, it becomes very far from self-evident.

Gilbert Montague, well-known corporation lawyer, has repeatedly presented a stock illustration of the difficulties faced by Americans doing business abroad. He describes how the success of an American business operating in a foreign country arouses a desire on the part of the foreigners to share in the profitable business. The American producer is thereupon given to understand that unless he consents to an arrangement restricting his share of the market or otherwise limits competition, measures will be taken to oust him, as by tariffs, quotas or a government monopoly, from the business he has built up. "If American nationals, under these circumstances, are liable to prosecution by the Department of Justice they will be as com-

the Congressional Committee Investigating Business Activities, May 23, 1944, p. 5.

[6] *Stenographic Report, June 6, 1944*, p. 28.

pletely debarred by the United States from doing business abroad as were the nationals of China and Japan during the centuries when these were the 'hermit nations.' " [7]

This stereotyped illustration is difficult to substantiate even by individual examples. As a phenomenon so common that it could debar a significant proportion of American businesses from trading abroad it is complete nonsense.

It is, of course, possible to conceive of certain hypothetical situations where participation in a cartel would be an essential condition to a company's ability to compete abroad. Certain basic patents, essential to efficient production, might, for example, be available only to cartel members. Or one can imagine a cartel so powerful that it could prevail upon the government of the importing country to grant quotas or import licenses only to cartel members. However, quotas are ordinarily not granted exclusively to cartel members. If an exporter should find himself excluded from a particular market as the result of governmental discrimination in favor of a cartel, the appropriate course of action would be a protest to the foreign government by our State Department.

Since most foreign countries are committed by existing most-favored-nation agreements with the United States to refrain from discriminating against American exports, the indicated method of proceeding under such circumstances is by way of official channels. Not only is this method in accord with the responsibilities of the State Department, but, notwithstanding inevitable delays, it has proved generally effective in the past and may be expected to be still more effective in the future. It is both safer politically and

[7] Gilbert Montague, "The Cartel Problem," *The Commercial and Financial Chronicle*, April 27, 1944, p. 1730.

surer economically than joining up with international cartels.

The majority of illustrations presented to substantiate the sort of hypothetical arguments advanced above have not been strictly relevant.[8] In the middle 1930's control over the importation of petroleum into Italy, which had been instituted earlier to enable a government-sponsored petroleum corporation to obtain a substantial share of the oil business in that country, was integrated with the control of foreign exchange. Russians and especially Rumanians were given more favorable treatment in the licensing of imports "because their currencies were more freely available in Italy." [9] The greater abundance of foreign exchange on these countries may be presumed to have been the result of a relatively greater volume of imports from Italy into Rumania and Russia than into the United States. The case may indicate the importance of facilitating imports as a means of encouraging exports, but it fails to support the view that American export business would have been aided by a relaxation of the restrictions imposed on monopolistic practices.

A little earlier, France introduced a quota scheme designed to assure French petroleum producers of a specified share of the internal market. The remaining fraction of domestic sales was allotted, on the basis of agreed ratios, among a number of foreign companies which were members of an international syndicate embracing all companies selling petroleum in France. It is alleged that if the American exporters had not participated in this cartel the quota would have been assigned to other members, French and

[8] Cf. Statement by R. W. Gallagher, May 23, 1944, pp. 8-10.
[9] *Ibid.*, p. 13.

foreign, of the cartel. Assuming that this is so—which there is no apparent reason to doubt—the example may be accepted as an instance where exports to a particular country were dependent upon American participation in an international cartel. Valid as this case may be, it does not go far toward establishing the argument that cartelization is important to the ability of American exporters to sell abroad. The case rests on highly specialized circumstances, and it is the only example of this character that seems to have come to light.

The view that simply by entering into cartel arrangements with foreign producers the problem of foreign markets would be resolved is scarcely in accord with experience. At one time I. G. Farben had an agreement with Sterling Products to the effect that certain pharmaceutical products should be supplied to the South American market by the company having the lower costs. But in 1934 when Sterling were able to deliver the products more cheaply, I. G. Farben refused to surrender the market, pleading the opposition of the German government.[10]

It is hardly correct that, as Mr. Gerard says and as is so frequently assumed, foreign countries "insist upon" cartels. In a limited number of cases, such as diamonds, rubber, tin and potash, there have been, it is true, governmentally supported raw material monopolies. But there has been no such insistence in lines where American exporters are directly and substantially engaged, where, that is, legal obstacles to complying with this insistence would constitute a serious handicap to American business.

It is obviously true that the legal environment of business

[10] Corwin Edwards, *American Economic Review Supplement*, March 1944, p. 336.

varies materially from country to country. For example, action in restraint of trade as we understand the term in this country was impossible in prewar Germany because the right to trade freely was simply not recognized.[11] However, the view, even if it were admitted, that American companies, in complying with provisions of foreign laws, may become liable to the charge of violating American antitrust legislation can scarcely be accepted as justifying an attempt to make our laws conform with those prevailing abroad. To advocate such a policy, if we consider our laws preferable, would amount to competitive depreciation of the laws governing business practices.

The fact remains, of course, that laws and court interpretations in foreign countries constitute an economic datum for those engaged in business abroad. Whether a country should oppose foreign legislation it regards as objectionable or should attempt to equip its nationals to deal with such laws—and whether cartels would be part of this equipment—are debatable questions. What is surely not debatable is that intelligent behavior by the government requires that it keep fully informed of legislative developments abroad and make this information readily available to its nationals.

AGREEMENTS WHICH RESTRICT EXPORTS

Cartel agreements have frequently been employed to divide world markets among members of the cartel. When an allocation of territory takes the form, as it often does, of keeping foreign producers from entering the domestic market, its effect is similar to that of a prohibitive protec-

[11] D. H. Macgregor, *op. cit.*, p. 6, and D. Warriner, *Combines and Rationalization in Germany, 1924-1928*, London, 1931, pp. 144-45.

tive tariff and the cartel is to be judged accordingly.[12] A cartel can thereby become the very efficient instrument for an invisible type of protectionism. Besides being more prohibitive than most tariffs, the introduction of this sort of trade barrier does not require an act of legislation. Moreover, it is not even necessary that the industry protected be, formally, a member of the cartel.[13]

Where an agreement takes the form of a promise not to compete in some third country, it overcomes an important limitation of ordinary protectionism, namely, that it is confined to the home country of the protected industry. By means of cartels, exporters may enjoy a privileged position in foreign markets as well as at home; and this extra-national protectionism may constitute a highly prized perquisite of cartel membership. In many instances it is probably a more important motive for cartelization than the reasons that are publicly given.[14]

In return for the agreement of foreign competitors to stay out of the United States market, American companies may agree to remain out of foreign markets. The fact that foreign producers find it desirable to resort to this means

[12] A typical agreement to allocate sales territory runs as follows: "Leverkusen agree that they will forthwith discontinue and not hereafter engage in selling or importing into the United States of America or Canada either directly or indirectly (except with the consent of Winthrop) all or any of the manufacture or merchandise of others."—*U.S.* v. *Alba Pharmaceutical Company, Inc., et al.* Civil 15-363, Complaint and Consent Decree, Schedule A, p. 22. Numerous cartel agreements and other documentary material are presented in detail in Irvin Hexner, *International Cartels*, Chapel Hill, 1945.

[13] Cf. the case of the Aluminum Company of America. Despite lower prices for the product abroad than in the United States, aluminum has never been shipped to the American market in significant amounts.

[14] Dr. Weidenfeld has declared that, as a corollary of this sort of division of the market, protective tariffs on goods controlled by international cartels have lost much of their *raison d'être.—Op. cit.*, p. 35.

of excluding our exports suggests that the foreign markets from which American exporters agree to abstain may be precisely those markets which would otherwise have offered the greatest opportunities for the sale of American goods. It seems likely that, by and large, the effect of cartel agreements is not to promote but on the contrary to restrict this country's export trade. Opponents of cartels not only deny that cartels are essential to the expansion of the American exports but contend that a substantial and healthy growth of foreign trade is likely to be fostered by the prohibition of cartels.

In addition, cartels are inconsistent with trade expansion because of their customary preoccupation with high prices and the protection of high-cost producers, conditions unfavorable to trade expansion where there is any degree of elasticity of demand. Believers in a dynamic, competitive economy cannot fail to see in the entire cartel philosophy a denial of the ideals of growth and expansion. Cartelists are obsessed by stability: they are concerned with "partitioning a livelihood," ignoring the possibility of expanding old markets and developing new through a vigorous policy of innovation, price reduction and competitive elimination of high-cost elements. Even when the restrictive effects of cartels are not directly discernible, the economic philosophy of cartelists is opposed to the trade expansion upon which they base their case for the legal authorization of cartels.

Even if it were certain that formation of a cartel would promote export trade in a particular commodity, it still would be necessary to examine the effect on exports of other commodities. Professor Edward S. Mason has declared that "there can be little doubt that international

cartels on the whole restrict the total volume of world trade and divert its channels." [15] A cartel which merely resulted in the displacement of one type of export with another—as might conceivably be the case—would be of doubtful benefit. If a cartel agreement gives our manufacturers an exclusive right to export to certain countries of Latin America, it may be at the cost of their freedom to ship to certain countries of Europe.

The artificial stimulation, by cartels or otherwise, of particular exports might tend to bring about a diminution of total exports, for the normal presumption is that the volume of trade will be maximized by allowing it to move without any sort of artificial interference. While diversion of trade from one channel to another may be justified under certain conditions, it is necessary at the very least to distinguish clearly between the diversion and the expansion of foreign trade; undue preoccupation with the effect of cartels on particular exports must not obscure the effect on total exports.

Apart from the effects on trade in commodities directly subject to cartel agreements, cartels may interfere with trade in goods partially dependent on the cartelized products. In the middle 1920's, *The Economist* declared that,

> Everywhere in Lancashire it is held that the chief cause of the decline of our export trade in cotton and piece goods is to be found in the prices which have to be paid for dyes.[16]

The high prices referred to were attributed to restrictive policies designed to benefit the chemical trust. Still more

[15] "The Future of International Cartels," *Foreign Affairs*, July 1944, p. 608.

[16] *The Economist*, February 13, 1926, p. 205.

explicit charges were advanced during the period of the depression:

The conclusion of the international agreement was followed almost immediately by substantial increases in the selling prices of domestically made dyestuffs with complete disregard for the precarious condition of many of the consuming industries during the period of national crisis. . . . Whilst dye makers in the shelter of . . . an international Cartel have no difficulty in increasing their prices, the exporter of textile goods finds it impossible in competition with the world to obtain any better prices. In fact, he has to cut prices.[17]

More recently the president of the Motor Agents' Association of England was quoted as saying:

Why is the production cost of a British motor vehicle 15 pence per pound weight as opposed to an American production cost of 9 pence per pound when wages in America are twice the hourly rate of those in this country? Sixty-five per cent of the production cost of motor vehicles goes in new and fabricated material costs and approximately two-thirds of this percentage is controlled by rings, combines and cartels.[18]

It would be futile to attempt to follow the effects of cartels through to their ultimate conclusion. Nevertheless, it is certain that their influence on trade is by no means confined to the commodities produced by the cartels.

Finally, to the extent that cartels are a "phenomenon generated by the need of adjusting the economic order to the conditions of restricted markets and slackening

[17] Third Report of the Dyestuffs Industry Development Committee on the present Position and Development of the Dyestuffs Manufacturing Industry in Great Britain—1932, Cmd 4191, pp. 13-14.

[18] *The New York Times*, September 25, 1944.

trade," [19] the question of what to do about cartels extends far beyond the possible effects cartels may have on foreign trade. It is also, and perhaps mainly, concerned with whether the future outlook appears to be conducive to economic expansion or stagnation. If one is resigned to a period of contraction and continuing trade disturbance, he may be expected to view cartels with a tolerance that will be absent if he looks forward to a period of expansion and advance. The general hostility toward cartels in the United States and the more favorable attitude toward them in England and on the Continent is perhaps one reflection of a more optimistic view in this country toward the economic opportunities that lie ahead.

THE AMERICAN EXPORTER IN A CARTELIZED WORLD

The record of our foreign trade contradicts the view that American business requires cartelization in order to hold its own in markets abroad. Thus the history of trade between the two world wars shows that the countries which made free use of cartels were on the whole less successful in export trade than the countries which did not. From 1932 to 1938, the export trade of the United States increased 90 per cent and of Great Britain 29 per cent, while that of Germany declined by 9 per cent.[20]

Even if foreign cartels should succeed in obstructing particular types of exports, it by no means necessarily follows that American business would be seriously affected. In relatively few industries are exports likely to constitute

[19] Pribram, *Quarterly Journal of Economics*, May 1935, p. 392.

[20] Cf. Theodore J. Kreps, "Cartels, a Phase of Business *Haute Politique*," *American Economic Review, Papers and Proceedings*, May 1945, pp. 303-4.

a decisive share of the business of American concerns. In the great majority of cases, if our inability to cartelize should result in our being excluded from particular foreign markets, we should nevertheless be able to keep going on the basis of our domestic business. We would thus be in a position to re-enter the foreign market as soon as the arbitrary restrictions or the price cutting that had kept us out were relaxed. In point of fact, reports of the threat of price cutting and of governmental policies designed to exclude non-members from a share in imports are partly inspired by a desire to bring about a relaxation of our restrictions on American nationals entering into cartels. The demonstration of a firm determination to maintain our policy would undoubtedly reduce the apparent danger.

In the long run, the producer who remains outside a cartel is likely to have an advantage over producers on the inside since he obtains the benefit of enhanced prices without having to carry any of the burden of restricting supply. If foreign producers, despite the failure of American producers to participate in the cartel, were to limit their sales in a particular market, the fact that American businessmen were free to sell there would afford a direct stimulus to our exports.

The picture of the poor American exporter struggling to hold his own against international cartels is anything but realistic. From the standpoint of producers in other countries, the position of our exporters appears in an entirely different perspective. Europeans have long taken the view that cartels constitute a means of enlarging the scale of their business units to proportions more nearly approximating the size of large American enterprises.[21]

[21] See Julius Klein in *American Industries*, June 1928, p. 5.

They look upon cartels somewhat as workers look upon trade unions; to them cartelization resembles a form of collective organization which makes it possible for smaller producers and producers in small countries to achieve a stature more nearly comparable with that of their competitors in the United States.

The large size of many American export enterprises is important in two ways. It signifies in the first place that in many instances the American concern is fully a match in financial and economic resources, in technical skill and bargaining power, for any foreign combination it may come up against. And in the second place American exporters may command so large a proportion of the trade in a particular line that if they refuse to enter into cartel agreements or are prevented from doing so, no effective cartel can be maintained.

A world dominated by giant cartels could only be a world in which American companies participated as active members of the cartels. Many relatively small producers in this country would inevitably be deterred from trying to enter the export market if they believed that entrance to the market was obstructed by tying contracts or collusive action among their powerful American and foreign competitors.

The growth of huge international cartels which included American companies would constitute a situation of world cartelization far beyond anything witnessed in the past. In all probability such a situation would lead to defensive measures by foreign enterprises and by foreign governments. Past experience with retaliation and direct governmental control of foreign trade is ground for believing that in a world of competitive cartelization the

position of American exporters as a group might be far less comfortable than it is at present.

The probability of increased governmental control of cartel operations is not confined to the possibility of action by foreign governments. It is reasonably certain that the granting of authority to establish monopolies in foreign trade would be accompanied by a strengthening of the control over those monopolies by our own government.[22] Greater freedom to cartelize would in all likelihood bring with it closer supervision. Every businessman who faces the issue of cartel policy must consider whether the legal authorization of cartels in American foreign trade, far from reducing governmental interference in business, might not lead still further away from laissez-faire.

EXPORTS, IMPORTS, AND THE PROBLEM OF FULL EMPLOYMENT

The question of whether cartelization is essential to American export trade suggests the possible implication that our exports are likely to need some sort of official encouragement. From an economic point of view, any increase of American exports which takes place without artificial stimulation is presumably desirable just as is an expansion of economic activity in almost any other sphere. But it does not follow that exports, in general or in particular, need to be singled out for special encouragement. Actually, there is much better reason for thinking that deliberate steps might be desirable in facilitating imports, since our ingrained political and economic traditions make

[22] See F. A. Lucas, "The British Movement for Industrial Reconstruction and the Control of Competitive Activity," *Quarterly Journal of Economics*, February 1935, p. 235.

the antagonism to imports, rather than any reluctance to export, a barrier to be overcome if foreign trade is to expand freely.

At the same time, a considerable shift has taken place in recent years in the prevailing conception of the position exports occupy in relation to commercial policy. In the past it was customary for economists to look upon exports simply as a means of paying for imports and to reject vigorously the layman's view that they were desirable in themselves. Even now it would not be denied that exports and imports are intimately related and that the surest way of increasing exports is to facilitate imports.

Many economists would now agree, however, that under conditions of partial employment exports may be desirable even though they are not balanced by corresponding visible or invisible imports. According to the argument, the loss of exports which might never be paid for may be more than offset by the higher level of employment caused by production for export. While the unpaid exports may represent a waste, the alternative idleness of labor and resources would constitute a still greater waste. Therefore, if the gain in employment which results from an increase of exports is large enough, the economy would be better off even though the exports were never paid for—but not as well off as if payment were received.

In a situation where deficit spending of some sort was felt to be justified because of its effect in promoting full employment, a practical reason for relying upon exports might be that legislative approval could be obtained for the subsidization of exports when it would not be granted for spending on internal purposes. A considerable body of conservative opinion in this country is accustomed to look

upon exports as intrinsically desirable. Those who favor exports are likely to be severely critical of relief projects of a make-work character. The stronger these sentiments are, the greater is the probability that exports may be relied upon as part of a full employment program, whether or not there is adequate provision for payment.

If exports are a means of promoting employment, it is even more certain that imports are a means of promoting exports. In any consideration of the relation of foreign trade to employment the question that immediately arises is whether imports would not tend to depress employment as much as exports would tend to promote it. The answer lies partly in the possible bearing of imports upon a rise in consumption; for the problem of maintaining a high level of employment is as much a problem of bringing about a substantial and sustained expansion in consumption as it is a problem of providing sufficient investment.

The reason for doubting that imports would offset the stimulating effect of exports on employment is that consumption is more likely to expand if imports are large than if they remain small. In the first place, imports of consumption goods include a relatively high proportion of luxury items, for which the elasticity of demand is much greater than it is for necessities. With higher spendable incomes people would presumably be willing to expand their consumption of goods of this character when they might not of other goods. In the second place, the greater the variety of choice, the greater is the elasticity of demand. In both these ways the larger variety of goods made available through importation would be favorable to a rise in consumption.

The relation of expanding foreign trade to a growth in

consumption is rendered doubly important by the fact that in a relatively wealthy economy such as ours, a rise in total consumption is the surest way of bringing about a long-run adjustment which will be conducive to the maintenance of full employment. Cartels are incompatible with this objective insofar as they tend to restrict rather than to increase the total volume of trade. A large proportion of cartel agreements contain provisions for allocating markets, typically limiting our exports to specified foreign markets in return for a restriction on imports into the United States market. To the extent that export restrictions of this character limit trade to markets to which they would otherwise move—and obviously they have no point unless, in fact, they have that effect—they retard exports directly. And to the extent that cartel agreements limit imports into the United States, their effect is to retard exports indirectly because of the familiar balance-of-payments principle that exports tend to move in harmony with imports. Because of the inherent tendency of cartels to restrict total foreign trade through their effects on exports and imports, they are far more likely to retard than to promote the attainment of full employment.

Most of the problems of international economic relations throughout the world will be greatly eased if we succeed in our declared policy of maintaining a high level of employment and income. It is not only that the United States, with its great size, wealth and economic power, occupies an important place in the world economy; a decline in business activity here may, as the experience from 1929 illustrated, have particularly unfavorable effects upon conditions in other countries. The pressure on raw material prices which occurred at that time; the strains imposed

on the balance of payments of countries producing these commodities; the measures introduced to meet the strains such as tariffs, quotas, exchange control and currency depreciation; the repercussions with multiple effect upon the economy of the United States—this entire succession of events might have been greatly modified if the initial contraction of production in this country had been prevented.

Neither the maintenance of a high level of employment nor a large expansion in the volume of foreign trade can be expected to eliminate the cartel question. Indeed, to the extent that either of these developments resulted in an increase of imports it might heighten interest in cartel agreements as a means of protecting the domestic market from foreign competition.

Analysis that runs in terms of total trade or turns on abstract economic principles leaves out of focus the problems of foreign trade as they are likely to confront individual businessmen. As long as there is foreign business to be had and cartel agreements seem to the businessman to be the means of having it most fully or most comfortably, there will be interest in cartels. Nevertheless, no matter how desirable cartel connections may seem to individual producers in this country, there is not the slightest ground for concluding that they are essential to—or even consistent with—the fullest and healthiest development of American foreign trade.

Chapter V

CARTELS AND THE AMERICAN PATENT SYSTEM

THE PROBLEM of international cartels is today inextricably involved with the subject of patents. Many of the restrictive practices for which cartels are criticized have been made possible by the patents granted to cartel members. The tendency to confuse cartel and patent abuses is exemplified in the fact that some of the objectionable practices which have been cited in the attack on cartels have occurred not in cartelized but in uncartelized industries.[1]

Patent cartels are only one of the forms which international cartels have assumed. That they occupy so large a place in the agreements in which American companies have participated is primarily because of the relative strictness of our laws against monopolies and the relative liberality of our laws on patents. In many instances patents have provided a means of accomplishing results which might otherwise have been held illegal under our antitrust laws.

The close relation of patents to the problem of cartels suggests that some modification of the patent law of this country is a necessary step in correcting the evils of international cartels. It further signifies that the practices for which international cartels are condemned have their counterpart in domestic trade; the problems associated

[1] Cf. Testimony of Thurman Arnold in Hearings on Scientific and Technical Mobilization, Vol. I, and Berge, *Cartels*, esp. ch. 7.

with cartels are by no means exclusively problems of foreign trade.

What makes the issue of policy especially complex is the difficulty of drawing a clear line between a reasonable exercise of the limited monopoly granted by a patent and the illegitimate use of this power to breach the Sherman Act. The issue is further complicated by the fact that the retention of trade secrets, "know-how," may be no less effective than patents in providing the basis of monopoly power. If businessmen choose to employ specialized knowledge in such a way as to limit output, resist progress or deteriorate quality, they presumably do so in order to increase profits and protect interests vested in private property. The danger of such restrictive action is more serious, no doubt, if businesses are allowed to form cartels. It is further aggravated by the existing framework of patent law. But the basic factor is the attitude of businessmen and the public on questions of commercial policy. It is safe to say that the restrictionist philosophy which gives more consideration to the maintenance of a relatively high level of prices than to the possibility of larger volume of sales with lower prices is not to be wholly exorcised by any categorical prohibition of a particular type of business organization or any possible modification of patent law.

HOW PATENTS ARE USED TO ESTABLISH CARTELS

The technique of employing patents to strengthen cartels is considerably more intricate than might be inferred from the simple fact that a patent gives exclusive rights to the patentee for a limited number of years. No single patent is likely to be important enough to afford the basis

for a monopoly of an entire industry, and if it were its life would be altogether too short to justify erecting a substantial cartel structure upon it. A patent is not to be thought of merely as a device for suppressing knowledge. On the contrary, the whole concept of the patent is opposed to the idea of keeping knowledge secret. The rationale of the patent contract is that the state agrees to grant a monopoly to the inventor in return for disclosure of a new discovery.

A technical process ordinarily entails two parts, the patent and the "know-how" necessary for its effective utilization. Patents always involve disclosure of important knowledge; it is retention of "know-how" that entails secrecy. However, a patent gives the right to sue if knowledge is appropriated without consent, while trade secrets, if discovered, become freely available to others. Consequently, a problem always arises as to how much of a technical discovery to disclose.

There is a constant conflict between sharing knowledge through the disclosure entailed in a patent, and sheltering knowledge through the retention of "know-how." If too little information is divulged, there is the danger, amounting almost to a certainty, that the knowledge will be discovered by someone else before long. Indeed, one of the safeguards against either the abuse of patent rights or undue retention of "know-how" is that ordinarily the exercise of a stringent monopoly by one individual will stimulate someone else to discover a way of doing the same thing.

Only when patents become part of a "fence" of related patents covering different parts of an intricate process or different ways of performing a particular operation is the

danger of a monopoly serious. For instead of individual patents covering separate products, there is, typically, a complex of interrelated patents and processes. Often it is necessary to employ a variety of patents to produce a single product and, conversely, a particular patent may be used in the manufacture of a number of different products. Similarly, the same "know-how" may apply to many products and mesh with many patents. It is usually impossible to segregate particular patents and "know-how." Consequently a pooling or interchange of patents, however desirable it may be when its effect is to make knowledge more widely accessible, may, under different circumstances, facilitate the conclusion of a restrictive international trade agreement.

Under a pooling arrangement a company desiring to use a certain process may be given access to the necessary patents subject to the stipulation that any patents it develops will be turned over to a patent pool. There then ceases to be any important independent source of patents. The agreement may provide the basis for a monopoly which is both powerful and self-perpetuating.

The mere threat of costly patent litigation may be sufficient to persuade producers to join in, or accede to the wishes of, a patent monopoly. Patents which are known to be of doubtful validity may nevertheless serve as the basis for threatened litigation. According to *Fortune*, "a big corporation, working from a base containing as many as 10,000 patents, can usually, if it wishes, find a basis upon which to pursue almost any competitor." [2] These tactics are likely to be particularly effective against relatively small, unorganized producers who may be in no

[2] "War and Peace and the Patent System," August 1942, p. 132.

position to undertake expensive lawsuits, however good their case.[8]

Most of the international cartels in which American companies have participated have been of the "patent-and-process" type, made possible through combining the rights afforded by a collection of patents. A patent-and-process agreement characteristically rests on the circumstance that an invention can be patented throughout the world and the patent gives monopolistic rights in each country where it is patented. Where an international cartel agreement can be built on patents the authority of the states granting the patents, far from being an obstacle with which to contend, is enlisted to enforce the policies and decisions of the cartel.

An invention can be represented by a series of patents which give monopoly rights in a succession of different areas. To secure a division of markets all that is then necessary is to allocate patents to the companies with which the market is divided. It is a relatively simple matter to "fence out" other producers from particular markets. If two companies exchange patents on a reciprocal basis, each of them acquires, in the markets where it operates, the combined strength of both companies. The patent strength of each is likely to be considerably greater after the exchange than the total power they enjoyed when operating independently.

A monopoly based on a patent-and-process agreement may be continued more or less indefinitely through renewals. Even if a court decision should abolish a particular

[8] As a partial safeguard against abuses of this character it has been suggested that the Department of Justice be instructed by law to defend licensees against infringement suits.—Cf. Hearings on Scientific and Technical Mobilization, Vol. I, pp. 19-20.

patent-and-process agreement, the division of the market based upon it might continue much as before since there would still be an incentive to behave as though the agreement were in force. The ownership of existing patents would presumably not be disturbed and the distribution of those patents would largely govern the ability of producers to make effective use of any new patents. The producers who held the old patents could afford to outbid others for the new patents and would find it profitable to do so. In short, a patent-and-process monopoly, once established, becomes more or less self-perpetuating and may continue to hold even after its contractual basis has been removed.[4]

CARTEL AGREEMENTS AND THE PATENT SYSTEM

The patent law, even though it provides for a limited monopoly, is designed, in the long run, to stimulate competition by the incentive given to discovery. The pooling of patent rights for the purpose of maintaining a continuing monopoly constitutes a clear violation of the intention of the law and an abuse of the privileges the law affords.

The object of granting patent rights, as the language of the Constitution explicitly states, is to "promote the progress of science and useful arts." To the extent that the long-run effect of cartels is to suppress the use of the process patented, restrict production or prevent others from introducing improvements, the purpose of the patent

[4] Justice Rutledge has shown that the same tendency toward a self-perpetuating monopoly may arise in purely domestic patent operations. —Cf. *Hartford-Empire Co., et al.* v. *U.S.*, 323 U.S., 449-50. Copyright trade marks have also been used as the basis of cartel arrangements. Cf. Fritz Machlup, "The Nature of the International Cartel Problem," in Corwin Edwards, Ed., *A Cartel Policy for the United Nations*, New York, 1945, p. 10.

provision is frustrated. By utilizing patent rights to acquire control of future patents and by making minor "gadget" patents, the safeguard conferred by the time limitation on patents may be circumvented and the monopoly extended almost indefinitely.[5]

International patent agreements are defended on the ground that by encouraging the exchange of patents they give a country access to the discoveries of foreign inventors, and facilitate the introduction of new methods in a more orderly manner and therefore with a minimum of disturbance. The significant question is what would have occurred in the absence of the cartel. In the case of a product based on a patent originating abroad, would the product have been supplied by imports or by a foreign branch factory in this country, and what price policies would have been followed? Or would the patent have been made available, either voluntarily or by compulsion, to American manufacturers, and what price policies would they have followed?

Similar questions arise in connection with patents originating in this country. In the absence of international patent agreements would the products based on these patents have been made available at lower prices? Whether it is correct that inventors in large corporations are their "captives";[6] whether inventors are rewarded inadequately or

[5] It is sometimes argued that the benefits of patents, which presumably were expected to accrue chiefly to the inventors, may be largely diverted to swell the income of a cartel. Both this contention and the counterclaim that large financial and technical resources make possible the effective development of inventions made by individuals of relatively limited means apply more to corporations than to cartels.

[6] Cf. Bone Committee, Hearings on Patents, Part III, p. 1739. It is said that inventors in all industrial corporations are bound by agreement to sell their patents to the company for which they work for one

—since their achievements are the result of the entire scientific heritage upon which they build—too generously; whether present legal provisions on the whole promote or retard progress, are questions partly philosophical and partly of indeterminable fact.

The evidence which is available simply does not provide an adequate basis for deciding what has been the net effect of cartel agreements on the functioning of the patent system in the United States. What is of major practical importance is a recognition that the two problems, patents and cartels, are intimately connected. Preoccupation with the evils of international cartels must not blind us to the shortcomings of our patent system, and no genuine solution of the cartel problem can stop short of a reform of the existing patent law.

THE BASES OF PATENT REFORM

The monopoly privileges accorded by patents are subject to distinct qualifications. Patent restrictions, for example, do not apply to the Federal government. Since 1910, the government has had the statutory right to make use, in peace or war, of any patented invention. This provision was broadened in 1918, largely at the instance, we are told, of Franklin D. Roosevelt who was then Assistant Secretary of the Navy. By this extension anyone who is engaged in producing for the government can use any patent that may be needed without the consent of the owner and without even negotiating with him.[7]

dollar or some similarly nominal amount.—Hearings on Scientific and Technical Mobilization, Vol. I, p. 16. This practice is defended on the ground that it facilitates the teamwork which is essential to successful collective research (Cf. *infra*, p. 87).

[7] Kilgore Committee, Hearings on Scientific and Technical Mobilization, Part IV, p. 687.

Moreover, a patent, while admittedly granting monopolistic privileges, does not specifically authorize all types of monopolistic practices. It is clearly recognized that a patent monopoly grants no right to violate other laws or to take action contrary to public policy.[8] For this reason patent rights cannot legitimately be used to violate the fundamental purposes of the Sherman Act.

Since patent rights are held to apply only within the limits of the general law, it has been denied that the sort of patent practices attributed to international cartels are legal. Thurman Arnold in testimony delivered before his elevation to the Federal bench expressed his belief that rights assumed to have been granted by patents could be withdrawn at the will of Congress:

Mr. Arnold: "The patent privilege is just like the privilege of the corporate franchise. It is perfectly all right for two corporations to merge, but when the intention is to dominate the market, that ceases to be all right. . . ."

Chairman: ". . . Do you have any question in your mind as to the rights of Congress to withdraw any assumed rights under the patent law?"

Mr. Arnold: "I have none."[9]

Decisions of the Supreme Court have had the effect of formulating a new law: the court has ruled that if a patentee makes use of the privileges given under a patent to assist in the creation of an unlawful monopoly, i.e., to extend his powers beyond the clear purposes of the patent, then the patentee comes before the court with unclean hands and cannot sue under the patent.[10]

[8] *Standard Sanitary Mfg. Co.* v. *United States*, 226 U.S., 20, 49.

[9] Bone Committee, Hearings on Patents, Part I, p. 642. See also Part III, p. 1739.

[10] *Morton Salt Company* v. *Suppiger Company*, 314 U.S., 488.

Notwithstanding these legal qualifications, the situation has been that this country, with laws unusually specific in their antagonism to monopolistic practices, has possessed a body of patent law as manifestly accommodated to stultifying the laws against monopoly. Our patent laws have differed from those of many other countries in their lack of provision either for compulsory licensing or for working the patent as a condition of its remaining valid. Each of these provisions has its faults,[11] but it is probable that they would have made it considerably more difficult to evade the spirit of the antitrust laws by means of patent-and-process agreements.

Patent reform as a remedy for the cartel problem is subject to distinct limitations. It does not get at restrictions based upon a monopoly of "know-how." Cartel agreements in industries making non-patentable products, or not using patented processes, would remain out of reach of this approach to the cartel problem. Moreover, the allocation of markets already effected by means of patents would probably, as was noted earlier, be little changed. The chief result would be to hinder future market allocation by means of patents, particularly in new fields where

[11] An individual inventor is likely to be unable, except in rare instances, to meet the expenses involved in exploiting his discovery. The possibility of the inventor losing his rights because of the working requirements might weaken his bargaining power in disposing of a patent. If, under such circumstances, an inventor were compelled to license his patent, it might fall into the hands of a large company which would then refuse to exploit it. The fact that the patent was already licensed would render it difficult to induce another company to take it up. As long, therefore, as large corporations are not compelled to exploit a patent turned over to them, the effect of such a transfer may be to lead to its suppression. While it would perhaps be unreasonable to require an inventor to develop his discovery, it might be wise policy to require him to grant a license to anyone who would agree to make full use of the patent.

no agreement had previously existed. Finally, since it is always a problem to decide how much of the knowledge essential to a process to retain and how much to disclose by patents, a policy which served to lessen the effectiveness of patents might tend to defeat itself by simply driving a larger part of technical knowledge into secret "know-how." This consideration is the more important in that cartels often depend more on their monopoly of "know-how" and experience than on any control they possess over patents.

RECENT COURT DECISIONS ON PATENTS

Thurman Arnold is more responsible than any other man for the vigor with which the campaign against monopolistic business practices has been pressed in the last few years. Following his appointment to the Federal bench, Judge Arnold delivered a number of significant decisions relating to patents. Their general tenor is best indicated in his statement that "the only real problem is to prevent patents from becoming a monopoly on technical progress in defiance of the Constitution." [12]

Judge Arnold contended that patent problems must be treated in full light of the facts of industry. In granting patents the authorities need to know not only details of the discovery itself but also how much control the patentee expects to acquire and how that control is likely to affect the activities of others in the field. Evidence should be obtained from disinterested experts and competitors who understand the monopoly problems in the field of the patent, as well as from the inventor.[13] "There is only one

[12] *Monsanto Chemical Company* v. *Coe.* 145 F. 2d, 23-24.
[13] *Ibid.*, 21.

possible way to determine the proper scope of protection for a single discovery. That is to examine the actual degree of control which the inventor hopes to gain by means of all of his claims taken as a whole, over competing industry and competing invention. *It is the duty of the Patent Office and of the courts to see that the reward is not in fact so large as to violate the Constitutional mandate by discouraging invention by others and thereby impeding the progress of science and the useful arts.*" [14]

The other main point of the Arnold decisions is to deny that patents are designed to protect discoveries achieved by group research in large corporate laboratories. "The patent law is designed to encourage competition among inventors by giving a patent to the ingenious individual who wins in a race for discovery. The modern corporate research laboratory is a negation of this principle because it is compelled to suppress competition between individuals." The court declared that the incentive afforded by the patent law is incompatible with organized research because of its tendency to destroy team work and cooperation.[15]

"The corporate research laboratory of today has given

[14] *Ibid.*, 20. Italics supplied. An illustration is given of a patent on a can opener, which might stimulate others to invent different types of can openers and thereby further the object of the Constitutional provision, in contrast with a patent which included the process of opening cans and would thus be so broad as to defeat the aim by discouraging invention. The court declared that carelessly drawn patents on formulas and ways of doing things have created *prima facie* monopoly rights over technical information and have made it possible to suppress invention, experimentation and initiative and to organize domestic and international cartels.

[15] *Potts et al.* v. *Coe*, No. 8189. 145 F. 2d, 27-30. "Individual achievement . . . is the aim of the patent law."—*Potts et al.* v. *Coe*, 140 F. 2d, 477.

us the greatest invention of modern times, the knowledge of how to invent." Nevertheless, "patents are not intended as a reward for a highly skilled scientist who completes the final step in a technique, standing on the shoulders of others who have gone before him. By the same token they are not intended as a reward for the collective achievement of a corporate research organization. . . . The 'inventor' is paid only a salary, he gets no royalties, he has no property rights in the improvements which he helps to create.

"To give patents for such routine experimentation on a vast scale is to use the patent law to reward capital investment, and create monopolies for corporate organizers instead of men of inventive genius. . . . It is sometimes argued that the investments in research by dominant corporate groups should be protected by law in order to encourage them to spend more money for research and thus extend that domination. The reading of such a principle into the patent law should require an act of Congress. It should not be established by judicial legislation." [16]

The gist of these decisions has been drawn together into a set of "fundamental principles of patent law," which Judge Arnold declared are "questioned by no one." [17]

a) A discovery which is the result of step-by-step experimentation does not rise to the level of invention.

b) Invention must rise above the level of accomplishment of the ordinary skilled technicians engaged in the art.

c) Patent law must be so administered as to promote science and the useful arts.

Judge Arnold's opinions on the subject of patents may be accepted as embodying advanced judicial thinking on

[16] *Potts et al.* v. *Coe.* 140 F. 2d, 474-477.
[17] *Potts et al.* v. *Coe,* No. 8189. 145 F. 2d, 28.

the relation of patents to competition and monopoly. While they have not yet been directly tested by the Supreme Court, a decision was handed down in the Hartford-Empire case early in 1945 which bears on many of the same issues. The majority opinion of the court was delivered by Justice Roberts with three members concurring, three abstaining and two dissenting.

By failing to support the abolition of patent rights where they had been used to maintain a monopoly in restraint of trade, the majority refused to continue the line of recent Supreme Court decisions. Instead they insisted that a patent is property and cannot be appropriated by either individuals or the government. For this reason "the courts, in enjoining violations of the Sherman Act arising from the use of patent licenses, agreements, and leases, have abstained from action which amounted to a forfeiture of the patents. . . . Repeatedly since 1908 legislation has been proposed in Congress to give the courts power to cancel a patent which has been used as an instrument to violate antitrust laws. Congress has not adopted such legislation." [18]

The court went even further and declared that "a patent owner is not in the position of a quasi-trustee for the public or under an obligation to see that the public acquires the free right to use the invention. *He has no obligation either to use it or to grant its use to others.* If he discloses the invention in his application so that it will come into the public domain at the end of the 17-year period of exclusive right he has fulfilled the only obligation imposed by the statute." [19]

[18] *Hartford-Empire Co., et al.* v. *United States, loc. cit.*, 415-16.
[19] *Ibid.*, 432. Italics supplied.

The minority opinions, written by Justices Black and Rutledge, were in substantial accord with the views expressed by Judge Arnold. Commenting on the conflict between the patent laws and the antitrust laws, Justice Rutledge declared that "the patent legislation presents a special case, the antitrust legislation the nation's general policy. Whether the one or the other is wise is not for us to determine. But their accommodation is one we must make, within the limits allowed to the judicial function, when the issue is presented. . . . When the patent-holder so far over-reaches his privilege as to intrude upon the rights of others and the public protected by the antitrust legislation, and does this in such a way that he cannot further exercise the privilege without also trespassing upon the rights thus protected, either his right or the other person's, and the public right, must give way. It is wholly incongruous in such circumstances to say that the privilege of the trespasser shall be preserved and the rights of all others which he has transgressed shall continue to give way to the consequences of his wrong-doing. . . . So inverted an idea of equity, or of the law, cannot stand." [20]

PROPOSED REMEDIES

Patent reform by judicial interpretation has already made considerable progress in the ruling of the Supreme Court that the use of patent privileges to accomplish unlawful ends impairs the patentee's right to sue under the patent.[21] Legislation might be drawn to specify that no one could sue for an infringement of an unexploited patent unless

[20] *Ibid.*, 452-53.
[21] *Morton Salt Co.* v. *Suppiger Co.*, 314 U. S., 488.

he could show that a license offered to others on reasonable terms had been refused. Other recent court decisions have served to emphasize the limitations on the powers conferred by patents—stressing particularly that the Constitution did not contemplate authorizing restrictions which have the net long-run effect of retarding progress and limiting output. The courts have ruled that while the Patent Office cannot revoke a patent once issued, it need not be bound by precedent in granting later patents. "The Patent Office can prevent a former erroneous ruling from having unnecessary weight by a subsequent ruling denying the same kind of claim to another party on a similar discovery." [22]

A somewhat different approach was adopted by Henry A. Wallace in a proposal for governmental support of technical research. Because of the heavy expense for laboratories, materials and workers, most of the industrial research being carried on before the start of the war was concentrated, according to Mr. Wallace, in about a hundred large corporations. As a result, smaller businesses were barred from many lines of development. "Unless the little man has access to the bounties of technology, free enterprise will suffer to the detriment of full employment of labor and our resources." He accordingly proposed that the government should make available the facilities necessary for industrial research and encourage the fullest utilization of significant findings.[23] *Fortune* magazine has sug-

[22] *Minnesota Mining and Manufacturing Co.* v. *Coe*, 145 F. 2d, 25.

[23] Kilgore Committee, Hearings on Scientific and Technical Mobilization, Part V, p. 705. Apart from any other criticisms that might be made, this reasoning underrates the extent to which really significant discoveries still come out of small laboratories.

gested, along somewhat similar lines, that a basic research laboratory be built up around the patents seized by the Alien Property Custodian.[24]

The most concrete and constructive suggestion for patent reform as a solution of the cartel problem calls for the compulsory licensing of all patents or the compulsory licensing of patents when they have been used to foster international cartels, e.g., by the allocation of markets.[25] A licensee would be required to pay a reasonable fee, reasonableness to be determined, if necessary, by the courts. An important advantage of a compulsory licensing-of-right provision as a means of attacking the cartel problem is that it would not require international action but could be applied nationally, since patents of both domestic and foreign origin would be affected.

Patent reform is no cure-all for the evils of international cartels. The fact that other countries with better patent laws than ours still have cartels does not, of course, prove that patent reform is of no significance, for these countries do not have the same laws as we against monopolies and some even have laws designed to facilitate cartelization. But because the exchange of patent rights seems to have been the principal means employed by American companies to engage in cartel activities, there is reason to believe that for this country a change in our patent regulations would assist in meeting the cartel problem.

Compulsory licensing could be expected to remove the most serious obstacles which our patent laws at present interpose to the solution of the cartel problem. It would

[24] September 1942, p. 152.

[25] Cf. Kilgore Committee, Hearings on Scientific and Technical Mobilization, Part I, pp. 92-93, for a statement of what Thurman Arnold regards as the legitimate and illegitimate use of patents.

furnish a safeguard against self-perpetuating international monopolies based on patents. In accordance with the underlying purpose of the constitutional provision, it would help to assure that patents would be used to facilitate and not to restrain the exploitation of new discoveries. Perhaps its greatest usefulness would be in improving the bargaining position of anyone desiring access to a particular patent. A company attempting to force another manufacturer at home or abroad to enter a cartel agreement, or trying to exclude him from a particular market, would be confronted with the possibility of being compelled to grant a license on terms laid down by the court. That threat alone might be enough, even without actual resort to compulsion, to forestall efforts to pursue an unduly restrictive policy.

Past experience holds out little ground for expecting early reform of the patent system by legislative means. The Supreme Court pointed out in the Hartford-Empire case that "Congress was asked as early as 1877, and frequently since, to adopt a system of compulsory licensing of patents. It has failed to enact these proposals into law. It has also rejected the proposal that a patentee found guilty of violation of the antitrust laws should be compelled, as a penalty, to license all his future inventions at reasonable royalties. The Temporary National Economic Committee recommended congressional adoption of such a system, but Congress took no action to that end." [26]

[26] *Hartford-Empire Co., et al.* v. *United States, loc. cit.*, p. 417.

Chapter VI

THE FRAMEWORK OF CARTEL POLICY

IF INTERNATIONAL cartels were as good or as wholly bad as their friends and foes are accustomed to paint them, the formulation of public policy toward cartels would be a relatively simple matter. The determination of policy is difficult because cartels have advantages as well as disadvantages, because future conditions in international trade are uncertain and will depend partly on our attitude toward cartels, and because the policies we adopt toward cartels cannot be entirely divorced from other policies we follow at home and abroad. The frame into which our cartel policy has to be fitted is a setting of conflicting considerations, somewhat inconclusive past experience and an ill-coordinated body of present and proposed procedures. While the precise limits of this framework are imperfectly defined, the main outlines, at least, are discernible.

THE DILEMMA OF PUBLIC POLICY

International cartels provide a mechanism whereby business units can engage in joint action while retaining their legal independence. The usefulness of such a device, since it permits business units to be accommodated to one setting without losing their identity in another, has been increased by recent political and economic tendencies.

On the one side, the forces of nationalism which divide the world along political lines have been strengthened by developments in this century and even in this decade. On the other side, economic activity tends to be governed not

by political differences but by relative differences in costs, and the strength of these economic differences has likewise tended to be strengthened by recent developments, particularly in the realm of transportation and communications. The result is a conflict between economic forces which tend to override boundary distinctions and forces of nationalism which tend to accentuate them. The problem arises of how to reconcile the expansionist drive of economic forces with the tightening grasp of national frontiers. International cartels provide a possible answer to this problem, since they enable national economic entities to unite to form economic systems which are international in scope.

The primary objection to cartels from the standpoint of international commercial policy is that they may violate the basic principles of foreign trade by imposing restrictions on the play of economic forces and thereby interfere with specialization along lines of comparative advantage. There is a *prima facie* expectation that the deliberate allocation of markets—or any other restraint on the freedom of enterprisers inside or outside the cartel to produce what they wish and to sell where they wish at a price they are willing to accept—is contrary to the long-run interests of the trading nations. To the extent that the net effect of cartel practices is to restrict economic activity, there is a presumption that cartels are contrary to the national interest.

The dilemma of public policy arises out of these opposing considerations, namely, that agreements between producers who would normally be competing may permit significant benefits to be realized and that such agreements are likely —some would say certain—to entail a restriction of eco-

nomic activity. The necessity of somehow reconciling this conflict is the heart of the cartel problem.

CARTELIZATION AND PRODUCTIVE EFFICIENCY

For any enterprise there is, at a particular time, some point at which most efficient production is technically possible. An increase in size up to this point can be expected to result in economies of operation, but increases beyond the optimum size would result in declining efficiency. The point of most efficient operation is governed by complex technological, administrative and marketing factors; it can seldom be precisely determined in advance, but in a free market tends to be established automatically. In order to increase profits, producers will enlarge their scale of operations up to the point of greatest efficiency and will cease to expand when that point is attained. The producers able to undersell their competitors will be those with the lowest costs of production and, other things being equal, they will be the producers nearest the optimum size. Competition serves to force producers toward their most efficient size, and to eliminate producers who fail to operate at the point of optimum efficiency.

The normal presumption that competition will tend to establish the most efficient scale of production applies in a free, relatively homogeneous market. For producers selling partly at home and partly abroad the presumption ceases to hold. If the most efficient size for a company's foreign operations is not identical with the most efficient size for its domestic operations, cartelization may provide a means of attaining the optimum size in each part of its business. The same reasoning which condemns cartelization when the business is domestic may support cartelization

when the business is partly domestic and partly foreign. The theoretical possibility that different optima exist for foreign and domestic operations provides the strongest logical basis that exists for the creation of international cartels.

For the sake of illustration it may be assumed that 90 percent of a company's business is done in the home market and only 10 percent in the foreign market, and that this ratio holds for each enterprise in the industry. If domestic operations of the company are carried on at the most efficient level, it may be that the foreign operations are on too small a scale to be most efficient. But if the company were to expand, as through merger or combination with other producers, until its foreign trade was conducted at the most efficient level, it would then be too large to be most efficient in its domestic operations and there might, in addition, be a danger of its becoming a monopoly.

If conditions permitted one company to operate exclusively in foreign business and others exclusively in domestic businses, the most efficient scale of operations might be achieved through specializing in either foreign or domestic business. Or again, it might be possible for exports to be handled through a broker who specialized in selling abroad. However, differences in location or other considerations might make producers unable or unwilling to solve the difficulty by these means. The dilemma would then remain that for an individual enterprise to approach closer to the optimum size in one part of its business would force it away from its optimum in the other part.

The problem of what to do in a situation where the most efficient size of enterprise for domestic trade is different from the most efficient size for international trade is not

to be resolved so long as each enterprise remains fully independent in all of its operations. If the optimum point for foreign operations is greater than the amount of business carried on by any of the companies acting alone, maximum efficiency may be possible only by allowing producers, while competing in their domestic business, to combine their foreign operations. Specifically, it may be possible by this means to eliminate competing salesmen, reduce costs of advertising, avoid duplication in market research, ship from the most convenient points, pool orders, and maintain maximum cargoes so that lowest rates are obtained. Warehouse and terminal facilities might be shared, with consequent economy of operation and improvement of service. Further benefits might be attainable through sharing knowledge and through centralizing such financial operations as borrowing and foreign exchange transactions.

It is precisely this sort of adjustment that cartelization is capable of bringing about. By definition a cartel agreement provides for some departure from competition, while allowing the contracting parties to remain independent. In effect, this was the primary significance of the Webb-Pomerene law when it was enacted toward the end of the first world war. That legislation created machinery for allowing competing firms which were fully independent in the domestic market to form associations for joint conduct of their foreign trade.

Business agreements which serve the highly commendable purpose of facilitating the attainment of a more efficient scale of operations in foreign trade are not without their dangers. In the first place, they may render it more difficult to enforce competition in domestic trade. "Can businessmen who get together on their foreign operations

in the morning be expected to compete vigorously on their domestic operations in the afternoon?" This practical objection may be serious enough to overrule the more theoretical advantage of allowing businesses to combine their foreign business for a closer approximation to the optimum scale of operations. The problem is whether business can serve two masters, the cartel in the field of international and individual enterprise in the field of domestic trade.

In the second place, cartel agreements may create profit opportunities in ways other than through their effect on efficiency of operation. The financial strength that is likely to accompany greater size may allow a concern to survive in competition with smaller producers, even in the face of higher unit costs of production. It may enable a large company to drive a low-cost competitor out of business, particularly if losses thereby incurred can be made up by charging higher prices in some other area where a degree of monopolistic control exists. Firms operating collectively may be able, by agreeing on uniform terms, to reduce losses and save on the cost of extending credit to customers. By showing a united front they may succeed in maintaining higher credit standards than would otherwise be possible.

For the most part, gains such as these are very different from the gains arising out of maintaining a more efficient scale of operations. However profitable they may be to the producers themselves, they are far less likely to be beneficial to the economy as a whole since their character is primarily that of a transfer from one group of the population to another, and their general tendency is to restrict total output. It is largely on this ground that monopoly is criticized and opposed.

The danger is perhaps always present that a degree of co-

operation which originates for the purpose of achieving economies of operation in foreign trade may degenerate into a device for exerting monopolistic controls. It is a question of whether the genuine or the socially spurious benefits of size continue to predominate, i.e., those that depend on the realization of operating economies or those that depend upon the exercise of monopoly.

EXPERIENCE WITH NON-COMPETITIVE TRADE POLICIES

The attention devoted to problems of American foreign trade during the second world war closely parallels the interest which developed during the first world war. Then as later there was much discussion of cartels and of the handicaps said to be imposed on American exporters by our antitrust laws. The existence and probable extension of strong foreign cartels was emphasized: "In seeking business abroad American manufacturers and producers must meet aggressive competition from powerful foreign combinations, often international in character. . . . In Germany prior to the war there were 600 important cartels . . . embracing practically every industry in the Empire." [1] American concerns must be allowed, it was urged, to deal collectively with aggregations of foreign purchasers of their exports.

The conditions arising out of the war were said to require collective action by American exporters because of "the convulsive effect of the present war on the commerce of the world. . . . The economic map of the world is being re-made. . . . The next few years contain possibilities of as far-reaching and enduring consequences to Ameri-

[1] Federal Trade Commission, *Cooperation in American Export Trade*, Washington, 1916, Volume I, p. 4.

can industry, commerce, and finance as perhaps any years in the history of the country." [2] These statements are almost identical with those advanced a quarter century later.[3]

A detailed study of the outlook for foreign trade was undertaken by the Federal Trade Commission before our entry into the first world war and culminated in the Export Trade Act, better known as the Webb-Pomerene Act, passed in April, 1918. According to the Trade Commission, four-fifths of all the reports received from manufacturers and producers in the export business were in favor of modifying the Sherman Act to allow cooperation in foreign trade. The Commission, with classic naïvete, described this consensus as "a striking expression of the convictions of those men whose knowledge and experience of competing conditions in international markets dictated their answers." [4]

In the course of the investigation attention was repeatedly directed toward the problem of the smaller producers; one of the principal reasons behind the Export Trade Act was to enable small companies, which could not afford to maintain adequate distribution facilities abroad, to join together for this purpose. All in all, the problems which gave rise to the Act closely resemble those that prevailed at the end of the second world war, and the law itself repre-

[2] *Ibid.*, p. 11.

[3] According to the Annual Report of the Federal Trade Commission for 1942 (p. 87), "associations report that a Webb law organization is particularly valuable when conditions throughout the world are changing as rapidly as they are today." The 1941 Report stated that (p. 146) "the associations feel that there will be more highly effective combinations of foreign buyers to deal with, as well as foreign government-controlled cartels, and that it will be more necessary than ever to meet these changed conditions by organized effort on the part of American exporters."

[4] *Op. cit.*, pp. 100-101.

sents our most deliberate excursion into non-competitive international commercial policies.

The Webb-Pomerene Act

The Webb-Pomerene Act specified that the privileges it accorded were to apply to associations organized "solely for the purpose of engaging in export trade and actually engaged solely in such trade." In accordance with the apparent meaning of these words, the associations formed in the first years of the Act were selling agencies, actually negotiating export sales and taking orders for their members.

An amendment was proposed in 1921 which would have extended the concept of export activities beyond actual sales so as to include agreements on prices and terms or any other "understandings among its members . . . necessary to protect them from combinations and practices of foreign competitors or customers." [5] The failure to act upon this amendment and the rejection of similar proposals earlier indicates that so broad a grant of power was foreign to the intention of Congress. Within a short time, however, means were found of effecting an even greater extension in the scope of the law.

By a remarkable executive ruling the Federal Trade Commission in 1924 threw the way open for the organization of associations for purposes other than the direct handling of export sales.[6] It announced that export associations might enter into trade arrangements with non-

[5] T.N.E.C. Monograph No. 6, p. 124.

[6] This ruling was given out as a press release but was not included in the annual report of the Federal Trade Commission. It is available in the T.N.E.C. Monograph No. 6, pp. 125-28. The ruling was opposed by two of the five members of the Commission.

nations (including "any cooperative relationship" in a foreign market), and might exist for no other reason than to fix prices and allot quotas. Declaring that the sole purpose of the Webb-Pomerene Act was "the lessening of competition between the domestic exporters in the foreign markets," [7] it stated that "the test of legality lies in result in most instances rather than in form or method pursued." [8] Where the law had forbidden an association to "do any act which artificially or intentionally enhances prices within the United States," [9] the Commission now declared that "it is well understood that an incidental or inconsequential effect upon domestic prices is not unlawful." [10]

By this ruling the Webb-Pomerene Act, instead of remaining primarily an instrument for legalizing cooperative sales organizations, was made to give its apparent blessing to a wide range of monopolistic practices in foreign trade.[11] For some of the associations the fixing of prices in export

[7] T.N.E.C. Monograph No. 6, p. 128. The terms of the announcement are in exact conflict with the interpretation of John D. Black and Stanley S. Tsou to the effect that "the Webb-Pomerene Act is intended to keep American firms from participating in international cartels."—*Quarterly Journal of Economics*, August 1944, p. 552.

[8] T.N.E.C. Monograph No. 6, p. 126.

[9] *Ibid.*, pp. 149-50.

[10] *Ibid.*, p. 128.

[11] A prominent corporation lawyer declared in 1933 that "one peculiarity of the antitrust laws is the frequency with which, under expanding interpretations of the Supreme Court, these laws have successively been found to be adequate to accomplish one after another many of the things which economists, publicists, and even several Presidents of the United States have at one time or another assumed were beyond the scope of the laws.

"Another peculiarity of the antitrust laws is that their periods of greatest growth have always immediately followed the periods when their critics have been most firmly convinced that these laws are hopelessly outmoded."—Introduction by Gilbert H. Montague to Edgar L. Heermance, *Can Business Govern Itself?*, New York, 1933, pp. xx-xxi.

markets, adoption of uniform sales contracts, agreement on credit terms, and the exchange of information among members became of greater importance than the actual handling of sales. According to *Fortune* magazine, "full-blown United States export cartels" existed under the Webb-Pomerene Act.[12]

The record of the Webb-Pomerene Act, as reflected in the number of associations in operation, the proportion of exports shipped by the associations and the published comments of companies participating, is far from impressive. Of the four associations organized in 1918, three were still operating in 1940, the last year that can be considered representative, but of the twelve organized in 1921 all had disappeared by 1936. From 1918 to 1940, one hundred and twenty Webb-Pomerene Associations were organized and seventy-seven were dissolved or discontinued. Out of forty-three associations in 1940, thirteen had been in existence twenty years or longer, while thirteen had existed no more than five years. Nearly half of the discontinued associations were dissolved within four years of their organization. A few of the associations surviving in 1940 had been inactive for various periods of time but were still nominally alive.

The period of most rapid growth in number of Webb-Pomerene Associations was during the years immediately after the passage of the law. In 1919, thirty-three associations were organized, in 1920 nine, and in 1921 twelve. Thereafter, with few exceptions, the number organized each year was considerably smaller. The total number of associations reached fifty-two in 1921 and fluctuated narrowly about that figure for the next decade. In the de-

[12] "No Peace With I. G. Farben," September 1942, p. 144.

pressed years of the thirties the total declined, reaching a low point of forty in 1934.

The record of dissolutions fails to substantiate the casual explanation of the Federal Trade Commission in 1940 that "the chief reasons [for dissolution], of course, have been connected with depression conditions during the past ten years." [13] In point of fact, there were fewer dissolutions in the thirties than in the twenties; the number of associations dissolved in the decade of the twenties was forty, compared with thirty-seven in the thirties. The maximum for any year in the thirties was seven in 1931, a figure equalled or exceeded in three years during the twenties. As many dissolutions occurred in the boom year 1929 as in the worst year of the depression.

The explanation of the growth in the number of associations during the twenties and the decline during the thirties is to be found in differences in the number of associations organized rather than in the number dissolved. From the standpoint of dissolutions, 1929 was one of the worst years, but it was one of the best from the standpoint of the number of associations organized. In the twenties the number organized exceeded the number dissolved in eight years and equalled it in one. In the thirties this experience was reversed: the number dissolved exceeded the number organized in seven years and equalled it in one.

The most rapid expansion in the volume of exports by Webb-Pomerene associations occurred after 1925. Between 1923 and 1929, while the number of associations rose from 47 to 55, exports increased from $140,000,000 to $724,000,000. In 1929 exports by Webb-Pomerene associations were 14 percent of total United States exports,

[13] T.N.E.C. Monograph No. 6, p. 145.

compared with less than 4 percent in 1923. The bulk of this increase was confined to two classes of commodities, viz., metals and metal products and the products of mines and wells. It was chiefly with respect to associations in these groups that the law was alleged to have been used to further monopoly following the 1924 ruling.[14]

In the two decades from 1921 to 1940 the proportion of American exports conducted by Webb associations ranged from 2 to 17.4 percent of total exports. In only three years, 1929 to 1931, was the proportion above 10 percent. It would be a mistake to regard these ratios as a measure of the accomplishments of the Webb-Pomerene Act, for there is no way of judging what the exports of the commodities included in these figures would have amounted to in the absence of the associations. The most that can be said is that the figures indicate what proportion of our exporters, as measured by volume of trade, evidently found it advantageous to make use of the privileges afforded by the Act.

The volume of exports handled by export associations fell sharply during the depression. Since the decline in these exports was considerably greater than for American exports as a whole, it is a little difficult to follow the Federal Trade Commission's contention that "the most successful years were not those in which the exports reached the highest figures. The real measure of success was achieved

[14] See especially L. T. Fournier, "The Purposes and Results of the Webb-Pomerene Law," *American Economic Review*, March 1932, pp. 19-32. "Copper Exporters, Inc., was incorporated . . . in 1926 as a direct result of the Silver Letter."—Sidney A. Diamond, "Webb-Pomerene Act and Export Trade Associations," *Columbia Law Review*, November 1944, p. 820. Dr. Fournier referred to "the increasing volume of business 'done' by associations which anomalously do not 'do' any business"—*Op. cit.*, p. 20.

during the depression period when the totals were smaller, but exporters, beset by trade restrictions and unsettled markets abroad, were still able to continue their organization and ship to foreign countries through their cooperative agreements." [15]

The failure of Webb association exports to hold up as well as exports in general is accounted for in part by the dissolution of associations during the depression. It may be partly attributable to the character of the products with which they dealt. On the other hand, critics of the law would doubtless regard it as evidence that the net effect of the associations in promoting exports was negligible—or, indeed, negative. In any case, it is clear that the experience with the Webb-Pomerene Act has failed to come up to the expectations and promises of its original advocates.

The nature of the benefits afforded by the Webb-Pomerene Act is suggested by the experience of the companies reporting under the Act in 1940.[16] Of the associations clearly stating their reasons for operating collectively, the largest number emphasized economies resulting from unified action, particularly economy through centralization of market investigation and sales. A smaller proportion mentioned the ability to control prices, terms, credit or production, and about the same number referred to both economy and control as constituting the advantages of the trade associations. More or less similar advantages were commented upon earlier by a number of associations which had passed out of existence by 1940.

The reasons offered by various associations for their dis-

[15] Annual Report of the Federal Trade Commission for 1940, p. 130.
[16] T.N.E.C. Monograph No. 6, pp. 154-233 *passim.*

solution may be accepted as indicating some of the shortcomings of the Webb-Pomerene Act.[17] One group of causes was made up of such factors as the failure of plans to materialize and a change in conditions of supply and demand which caused the association to become superfluous. Included also were such considerations as the completion of the plans that led to the formation of the associations, a desire to revert to individual operation, dissatisfaction and litigation among members, and replacement by another association. Causes of an external character include depression, the imposition of trade barriers abroad (factors which are closely related) and the pressure of foreign competition. Where foreign competition was given as a reason for dissolution, the low costs of foreign producers, notably Japanese manufacturers of buttons, seem to have been responsible for the failure of the associations to hold out, rather than any defect in the law. The basic difficulty was that the comparative advantage possessed by foreign manufacturers was simply too great to be overcome by any economies or other benefits obtained through combining.

The severest charges of monopolistic practices under the Webb-Pomerene law were directed against the copper industry. The Copper Export Association was organized in 1919 and took an active part in preventing distress selling of stocks of copper accumulated during and after the last war. A number of members withdrew in 1924 and the association ceased to be important, though it continued in existence until 1933.

In 1926 Copper Exporters, Inc., was formed with a membership drawn largely from the older association. By the

[17] *Ibid.*

following year its members controlled nearly 94 percent of the output of copper in the United States and nearly 85 percent of world output.[18] According to the T.N.E.C., Copper Exporters "centralized sales, allocated quotas, and fixed the price of copper throughout the world," and the same source reports that tribute was levied on consumers to the amount of $100,000,000 in a single year.[19] The price of copper in the New York market rose from 12.4 cents a pound in 1927 to 21.3 cents in 1929. What was more remarkable, between April 1929 and April 1930, notwithstanding falling sales and rapidly rising stocks of the metal, the price of copper remained unchanged at 18 cents. Then the price was simultaneously lowered 4 cents a pound in all markets. During 1930 the price of copper fell below 10 cents per pound and in 1932 below 5 cents.

The activities of Copper Exporters, Inc., aroused a feeling of great bitterness among consumers in the principal European markets. In addition to cabling repeated protests to this country, the consumers abroad resorted to organized buyers' strikes. Dr. Fournier has expressed the view that the association's operations were "almost constantly in restraint (in the sense of curtailment) of the copper foreign trade of the United States." [20]

Notwithstanding the evidence of Copper Exporters, Inc., to regard the Webb-Pomerene associations as existing solely for the purpose of cloaking monopolistic practice at home and exercising against foreign consumers a degree of

[18] T.N.E.C. Monograph No. 21, p. 223, and cf. Fournier, *op. cit.*, pp. 24-31.

[19] T.N.E.C. Monograph No. 21, p. 223.

[20] *Op. cit.*, p. 25.

monopoly which is prohibited in the domestic market is unduly cynical.[21] The original intention of the framers of the law was something far more modest and genteel: it was to enable exporters to avoid pointless duplication of sales forces, market research, shipping facilities and the like; and to enable the necessary marketing organization to function at a more efficient level. In more technical terms, the Webb-Pomerene Act was designed, in substance, to make possible a closer approach to an optimum scale of operations in foreign trade without destroying the independence of participating firms in the domestic trade.

The relaxation of antitrust restrictions under conditions such as these, far from leading to the exploitation of foreign purchasers, may work to their advantage: by enabling them to be served more efficiently it presumably tends to bring about a lowering of the prices of goods exported. Something of this sort may be in the minds of those who maintain that the purpose of the Webb-Pomerene Act was not to reduce but to increase competition in foreign trade.

The rationale of the Webb-Pomerene law, however far accomplishments may have fallen short of the ideal, was substantially that it enabled companies to retain their existing size for purposes of internal operations and to combine their international operations in such a way as to approach more closely to the most efficient size for the export side of their business. Business arrangements of this character are entirely defensible on logical grounds. While technically cartels, there is no reason why any sinister connotation should necessarily be attached to them.

[21] For an opposite point of view, holding that it is inconsistent to believe that combination can be good in foreign trade and bad in domestic trade, see Diamond, *op. cit.*, p. 826.

Other Non-Competitive Trade Practices

During the middle thirties various types of imports from Japan, including cotton goods, hooked rugs, electric light bulbs and many assorted items, though not very large in amount, were increasing at a rapid rate. Domestic producers became greatly agitated and made strong representations for an increase in import duties, and it seemed highly probable that the requests would be granted. However, so-called "gentlemen's agreements" were entered into with representatives of the American and Japanese interests involved. The Japanese producers, who were organized into what were in effect cartels, promised to limit exports to the United States to an amount small enough to allay the fears of the Americans.[22] These "gentlemen's agreements" worked to the apparent satisfaction of both countries. It was generally believed that the restraints they imposed on trade with the United States were less severe than this country would otherwise have introduced. If this belief is accepted as correct, the cartels may be said to have served the cause of more liberal commercial policies.

Numerous international business agreements provide for the exchange of technical discoveries, especially the swapping of patents in the chemical and electrical industries. Assuming that the information and rights thus acquired are utilized and not directed toward maintaining restrictive policies, the exchange amounts to freedom of trade in ideas and is not only in harmony with the basic theory of international commercial policy but constitutes a most commendable extension of economic interchange.

[22] Cf. Percy W. Bidwell, *The Invisible Tariff*, New York, Council on Foreign Relations, 1939, p. 135.

Even though, in general, cartels may be inconsistent with a policy of trade expansion, it must still be remembered that they constitute only one of many such inconsistencies in United States policy. The protective tariff, the subsidization of the exports of a number of agricultural products, aid to merchant shipping, to name only some of the more conspicuous, are contrary to the same basic principles with which cartels are in conflict.

INTERGOVERNMENTAL COMMODITY AGREEMENTS

Probably the most controversial question relating to the consistency of our foreign economic policy arises in connection with intergovernmental commodity agreements. For we find the government discussing or concluding international agreements for the control of trade in petroleum, wheat, sugar and perhaps other commodities at the same time that it is conducting a vigorous campaign against private agreements for the control of foreign trade. Yet both types of agreements are frequently classified as cartels, and in the past the United States government has strongly opposed certain international commodity agreements, notably those in rubber, coffee and tin.

It may be that the contradictory attitude toward intergovernmental commodity agreements and private cartels, particularly in manufactured products, is logically and economically indefensible. The sharp division of opinion among the experts, in government and out, on our policy toward commodity agreements lends support to such a conclusion. It clearly makes the difference where the shoe pinches, and the fact that powerful groups in this country are interested in commodity agreements may be all the explanation that is required.

The matter of consistency in economic policy is itself, of course, a debatable issue. While it is popular to disparage extreme preoccupation with consistency, few would deny, surely, that it is desirable to adhere to considered standards of policy. To hold otherwise is to throw judgment to the winds and rely on expediency or whim. The difficult part of determining consistency is in arriving at the basis by which consistency is to be judged. There is no fundamental contradiction, for example, in advocating freedom to trade in wheat while endorsing rigid control of trade in narcotics; the standard by which consistency is measured is not freedom or lack of freedom to trade but the health and well-being of the community. In maintaining opposite policies on trade in these two types of goods we do so, presumably, in order to conform to a more significant criterion of consistency.

The same considerations apply with respect to the different attitudes adopted toward intergovernmental commodity agreements and cartels. Admitting that the ultimate basis for judging the wisdom of a particular policy is the national interest, the contradiction in policy on cartels and commodity agreements must be justified, to the extent that justification is possible, on the basis of the differences existing between them.

The most significant difference is in the nature of the commodities concerned. Some of the products subject to commodity agreements are of great military value, as in the case of rubber, tin and petroleum. For some, notably petroleum, conservation is an important consideration. In cases such as these, not only does the state have a strong interest, but also the basis of policy is largely non-economic in character. In other instances, such as sugar, wheat and

cotton, prices have been subject to extreme fluctuations which had led to widespread disturbances.

The possibility of a critical situation developing in a number of primary products has been greatly enhanced by the expansion of productive capacity which took place during the war, precisely the situation, on a much greater scale, that contributed to the spread of control measures after the last war. Many of the commodities affected are subject to highly inelastic demand and supply, with the result that price changes constitute a clumsy means of effecting economic adjustments. Under free conditions prolonged depression, with the ultimate destruction of productive capacity which will be required later, is a distinct probability. Past experience suggests that such a situation of excess supply "is not self-correcting—or, in so far as it is self-correcting, the suffering involved in the process for the producers of the commodity is likely to be so distressing that nations are unwilling or unable to permit the 'natural' process of readjustment of supply to demand to proceed." [23]

Countries, the United States included, have in the past attempted, when acting independently, to alleviate disturbance of this sort by subsidies or by direct quantitative regulation of trade in the commodities. Under these circumstances, various countries, again including the United States, have resorted to countervailing duties or other forms of retaliation. Perhaps the strongest argument in favor of intergovernmental commodity agreements is that they will prevent economic warfare of this character.

Professor B. F. Haley, until recently Director of the

[23] Bernard F. Haley, "U. S. Policy Regarding Commodity Agreements," *The Commercial and Financial Chronicle,* July 5, 1945, p. 123.

Office of International Trade Policy in the Department of State, has indicated the place of international commodity agreements in international economic relations. Their function, he says, is "to provide governments with facilities for reconciling their economic policies in respect of seriously depressed branches of primary production with the broad requirements of an over-all program of international economic expansion. Their purpose should be to deal with cases of actual or imminent international economic maladjustment of a serious nature. It is not intended that this form of international economic cooperation should be deliberately fostered as a permanent method of organizing international production." [24]

The defense of commodity agreements on grounds such as these is essentially of a "practical" character. Its validity rests on the assumption that the alternative to the conclusion of an international agreement is the adoption of restrictive and retaliatory policies which are still more uneconomic and objectionable. The possibility that the intergovernmental agreement will tend to maintain artificial prices, freeze production and allocate resources uneconomically may be no less serious than in any other sustained departure from competition, but these dangers may appear considerably less forbidding than those of economic warfare.

This reasoning is similar to that advanced in the "wave-of-the-future" argument for cartels which was examined earlier and rejected. The two cases are not parallel, however, since commodities customarily subject to cartel agreements are of so different a character. Cartels agreements have generally involved manufactured products which were dependent upon patents granted by the state

[24] *Ibid.*

and often were concentrated in the hands of a few producers. There is no likelihood whatever that trade in these commodities will lead, in the absence of international controls, to economic warfare.

The relatively large number of enterprises ordinarily concerned in the production of commodities subject to intergovernmental commodity agreements is itself a fact of considerable importance. The benefit from establishing a higher price for wheat than would otherwise prevail will be diffused among millions of producers; the benefit from establishing a higher price for some new plastic is likely to be much more narrowly concentrated. The economics of the two cases goes much deeper than considerations of justice or abstract equalitarianism. In the first place, the indirect effects of the broader distribution of gain on the flow of income and expenditure are likely to be of importance. But more significantly, if there are many producers, each free to increase his output, and if there is free entry for new producers, the actual and potential pressure from within the organization constitutes a check on the control being used to maintain very excessive prices for long. In the case of a highly concentrated monopoly there is no assurance of any such automatic internal check on the abuse of monopoly power.

Finally, commodity controls of the type now being given serious consideration in this country are subject to governmental authorization and administration. Presumably they are based upon different standards and different motives from those which apply in the case of cartels. Their immediate purpose, nominally at least, is to promote the interests of society as a whole rather than the profits of a

small group. If these presumptions do not hold and the ends of the control become restrictive rather than remedial, a governmental monopoly may be as objectionable as one that is wholly private. Indeed, governmental participation, by rendering it more powerful and more permanent, may make the control just so much the worse. Under those conditions, "there is no reason to suppose that Government-sponsored international cartels would be any better than private ones. . . . Government-sponsored cartels are among the choicest specimens in the rogues' gallery of international economics." [25]

The differences between commodity agreements and cartels, then, may be sufficient to render policies of favoring the one and opposing the other entirely consistent from the standpoint of national interest. There is no guarantee, however, that this will be true; the loss may be as great in one case as in the other. In a free enterprise economy the presumption is against both alike.

The great danger in centralized control of economic activity, whether the control is public or private, is that by tending to freeze production it will interfere with adaptation to changed conditions of supply and demand, and thereby will prevent the most economic allocation of resources. It is a most important rule, chiefly honored in the breach, that governmental measures involving departure from competition should contain provisions designed to make their long continuance unnecessary. It is not enough, for example, to support the price of wheat; means should be provided for adjusting the basic relation between supply of and demand for wheat.

[25] *The Economist*, December 2, 1944, p. 725.

FREE COMPETITION AND ITS ALTERNATIVES

The philosophy of free competition rests on certain basic assumptions. In the first place, competition offers an incentive to the individual enterpriser to produce as efficiently as possible. Secondly, it affords a guide to indicate what to produce and who should produce it. Adjustments to changed conditions are thereby facilitated. Finally, it furnishes an automatic safeguard against the exploitation of one group, such as consumers, labor or employers, by another group, such as labor, employers or consumers. These are inherent virtues of a high order. In a democratic economy such as ours, even though the ideal may not always be fully achieved, they establish a presumption in favor of free competition as the governing policy.

Bases of Differentiation

If it were necessary to choose one alternative or the other, a blanket prohibition of cartels, national as well as international, would be preferable to their outright authorization. But any such unbending insistence on competition would also entail sacrifices. As *The Economist* has remarked in another connection: "It is a matter of the most obvious common sense that, in this day and age, the best form of economic organization for a complex industrial country lies somewhere between the extremes of *laisser faire* and bureaucracy, of full control and no control." [26] In conditions of a natural monopoly or of differing optima in foreign and domestic trade, competition would not lead to the theoretically most economic results. Nor is the protection afforded by competition equally necessary under

[26] June 23, 1945, p. 837.

circumstances where other safeguards, whether under public or private auspices, are adequate.

The presumption in favor of free competition holds where the ends are economic. Where other considerations predominate over the economic there is no necessary presumption in favor of competition. In a free economic society the general rule is free competition; but it is a rule which applies only in matters economic. Where social goals are primarily non-economic, free competition, which is an economic program, ceases to be pertinent, or at least there is no longer any clear presumption that competition constitutes an adequate standard for the formulation of policy. Even when competition is not the indicated policy, however, cartelization does not necessarily take its place, since cartels represent only one of the possible alternatives to free competition. Cartelization must be compared with the other alternatives, of which nationalization and competition under governmental control are the most important.

For years to come we may expect to face a world in which war and technological advance have brought enormous economic change: excess productive capacity, dislocation of production and distribution, distorted foreign exchange relationships and altered patterns of transportation and communications. The importance of these changes is beyond dispute; the only question is whether competition, cartelization or some method of administrative control constitutes the most promising means of accommodating the economy to the changes that have taken place.

Dislocations are an accomplished fact and the consequences of these disturbances will have to be endured, whatever policy is adopted. Alternative policies, such as competition and cartelization, represent different ways of

distributing the burdens resulting from the dislocations but none of them will allow the burdens to be avoided. Assuming that there is overcapacity, the costs under competition will presumably take the form of losses and bankruptcy; with cartelization they will take the form of supporting excess producers. Costs of transition will arise regardless of the course that is followed.

The Problem of Conservation

The mingling of alternative considerations is likewise observable in connection with the troublesome question of conservation. The lavish use that has been made of our natural resources is doubtless more to be ascribed to their abundance than to the keenness of competition in American business. The view often expressed that some sort of monopoly would contribute to a policy of conservation is based partly on the idea that the higher prices charged by a monopoly would reduce the volume of sales and therefore the rate of exhaustion of resources, and partly on the belief that in the absence of competition more conservative methods of extraction could be employed.

The unduly low prices that sometimes exist under free competition may lead—because of taxes and other overhead costs—to wasteful methods of production. Nevertheless, the rise in price that occurs when supplies become scarce is itself a powerful factor in stimulating conservation, especially if long-term interest rates are low. Price adjustments under free competition not only contribute to the conservation of resources, but they do so automatically. On the other hand, the automatic inducement to conserve does not always operate effectively and therefore, under some circumstances, a cautious public policy calls for a departure

from strict competitive conditions.[27] But it by no means follows that the departure from free competition for the sake of conservation has to take the form of international cartels.

Cartelized, like competitive, enterprise is primarily directed toward maximizing profits, and there is no guarantee that there will be less waste of resources under cartelization than under competition. The relevance of monopoly to conservation depends in considerable part upon the characteristics of the industry in question. The argument, if it applies at all, relates to a minute sector of the problem either of international cartels or of conservation. Most conservation problems are domestic in character and therefore are largely distinct from the subject of international cartels. Likewise, the majority of international cartels relate chiefly to manufactured products, to which the issue of conservation does not directly apply.

Even in those instances where competition may be directly responsible for waste of resources, as in the production of petroleum where divided ownership may lead to over-drilling and wasteful extraction, the remedy is to be sought not so much in cartel agreements among independent producers as in single ownership or rigid governmental control. The question of whether or not a cartel is desirable from the standpoint of conservation cannot be left to private individuals whose attitude toward cartelization may be influenced by so many other considerations. At most, the conservation argument offers a defense for limited cartelization under strict governmental supervision; it provides no support for a blanket endorsement of international cartels.

[27] See M. W. Watkins, "Raw Materials, an Analysis and a Proposal," *American Economic Review*, June 1944, p. 243.

State Trading

A different set of problems is raised by the political aspects of competition and cartelization. Particular interest attaches to the question of economic relations with Russia, or other countries where there is a system of state trading. It is frequently overlooked that the control of all of a single country's foreign trade in a commodity is very different from governmental control of total world trade in that commodity. Even though in a country such as Russia there is no such thing as competition among importers, the price charged by exporters shipping goods to that country could presumably be governed by the price established through competition in the world market or in the country of export, with adjustment for differences in cost of transportation.

In the hypothetical case where a state-trading country constitutes virtually the entire market for the total world trade in a product, special treatment would be called for. But this is a highly academic question: we have had experience with state monopolies in the export of such commodities as rubber, coffee and tin but never in modern times has a single country or group of countries held a monopsonistic position in any importantly traded international commodity. In any case a profit-based private cartel is hardly the instrument for coping with such a situation. There is something incongruous in suggesting that so extreme a form of capitalistic business organization as the cartel is essential to the prosecution of successful trade with so socialistic a country as Russia. For political as well as economic reasons, state control of imports would call, at

the most, for some sort of control of exports which would enable state to deal with state.

Governmental Participation in Cartel Management

The possibility has been suggested of the government participating in the management of cartels. In that capacity it would know what was going on and would be able, according to the argument, to protect the interests of consumers, prevent abuses and, at the same time, increase the effectiveness of cartels. No enthusiasm has developed for this solution from the side of business, government or the public. Apart from the question of whether such a system could be both efficient and harmonious, there is a strong probability that it would lack flexibility. Critics of the cartel philosophy tend to oppose it precisely because it might render the cartel that much more effective. There is the further objection, emphasized by Herbert Hoover when he was Secretary of Commerce and reiterated by Secretary Hull in his communication to President Roosevelt on cartels, that participation by the government aggravates the danger that measures for controlling trade will lead to serious discord between countries.

Finally, there is the problem of the effect which support given cartels in international trade might have upon the enforcement of antitrust legislation within the United States. Without question it would make the task of the Department of Justice more difficult in many ways. It would facilitate informal understandings in the domestic market and serve to exclude foreign competition from this country. On the other hand, the intimation that cartels, by reason of their size and power, may exert a demoralizing

influence upon business practice and governmental policy —whether by outright bribery or by subtler forms of pressure upon government officials—is hard to disengage from a mere condemnation of bigness. Large size is not a peculiarity of cartels. A firm in an entirely uncartelized industry may be larger than a cartel and may, conceivably, be able to exert influence at home or abroad as great as that which a cartel could bring to bear.

Chapter VII

PROPOSALS FOR SOLVING THE CARTEL PROBLEM

BOTH SUPPORTERS and opponents of cartels agree that the present status of our policy on international cartels is thoroughly unsatisfactory. On this point there is unanimity even among those who believe that our internal antitrust policy should stand approximately as it is. Defenders of cartels hold that present legislation discriminates against American businessmen doing business abroad, confronts them with conflicting sets of laws and subjects them to needless uncertainty as a result of changing interpretations of the law. Critics of cartels would have the law against restrictive practices by cartels made more explicit and would close loopholes which now exist, notably those relating to patents.

The basic economic issues have been muddied, unfortunately, by the inclusion of many distinct though related questions. The confusion is partly the result of the fact that the prevailing attitude toward cartels is colored by war hysteria, xenophobia and the latent hostility that exists toward big business, especially when big business is identified with absentee ownership. The presence of these highly contentious considerations is partly accidental, partly coincidental. Deliberately or not, they have been used to prejudice the case against cartels until, as has been remarked, the word "cartel" has become less a name than an epithet. The situation is further complicated by the fact that competition and monopoly never exist in a pure form. There is

some competition within even the most binding cartels and some administrative control under competition.[1]

The application of American policy toward monopolies has varied with the spirit of the times. "Fifty years ago, when a national antitrust policy was enunciated in the Sherman Act . . . no attention was paid to the fact that the most effective monopoly of the time was the small retailer—the general store at the crossroads—whose customers were as dependent upon this single source of supply as the desert inhabitant on his oasis." [2] We have had our trust-busting days of Theodore Roosevelt and our cartel-busting days of Thurman Arnold and Wendell Berge. But in between, we also had a "virtual moratorium" on the Sherman Act, to quote the opinion of a businessman,[3] under Harding, Coolidge and Hoover; and later we saw the N.R.A. established to make restriction of competition compulsory.

Proposals for solving the cartel problem are as varied as they are numerous. At one extreme is the suggestion that we cease to speak of "cartels," calling them "trade accords" instead (as if by words we could help to exorcise the problems to which the words relate), and not only remove all impediments to their development but introduce positive measures to encourage them. At the other extreme are plans for the creation of elaborate machinery, under the government or within industry itself, for evaluating, guiding and supervising international business arrangements.

[1] See the illuminating discussion in Robert A. Brady, *Business as a System of Power*, New York, 1942, especially Chapter I.

[2] Willard Thorp, Monograph No. 17, Problems of Small Business, T.N.E.C., Washington, 1941, p. 147.

[3] Quoted in Karl Pribram, *Quarterly Journal of Economics*, May 1935, p. 381n.

CLASSIFICATION OF PROPOSALS

On the basis of the means for meeting the cartel issue, proposed solutions may be classified as legislative and administrative. Those of a legislative character include patent reform, proposals for federal incorporation and the modification of the Webb-Pomerene Act. The distinguishing feature of the proposed administrative reforms is that they would provide for the establishment of new machinery for dealing with cartels. The administrative organization might be either governmental or private. The particular types of machinery proposed vary from bureaus of the government to federations or associations of business enterprises, with or without representation by the government or consumers. The two categories of solutions, legislative and administrative, are not mutually exclusive, since recommendations for creating additional machinery may be combined with proposals for substantial modification of the legal framework within which they would operate.

Proposals for meeting the cartel problem may also be classified according to their source. Among the principal plans meriting consideration are suggestions emanating from a Congressional committee, a committee consisting of representatives from different departments of the government, the Department of Justice, groups of businessmen including the Foreign Trade Council in this country and the Federation of British Industries in England, and from individual businessmen and economists.

A final basis of classification is by the results the proposals seek to accomplish. This method of distinguishing among the proposed solutions best contributes to clarifying the major issues and the differences in fundamental approach,

and will be followed here. Sources of the plans and the methods they embody will be indicated in passing. It may be said at the outset that proposals range all the way from those designed to prohibit cartels to those designed to give them the utmost freedom to develop. The extreme pro-cartel solution is not one where the government would impose no obstacles to cartelization; it is where the authority of the government would be enlisted to compel the remaining producers in an industry to join a cartel if a large majority, embracing, say, 80 per cent of an industry, have voted to establish a cartel. This sort of compulsory cartelization is embodied in the laws of a number of countries and is to be regarded as the ideal of thorough-going advocates of cartels. In principle it is not unlike provisions in labor legislation enabling a majority of the workers in a particular establishment to compel the remainder to become members of the union for that establishment.

PROPOSALS DESIGNED TO PREVENT CARTELIZATION

The leading proposal thus far advanced for dealing with the cartel problem, at least as regards the weight of authority behind it, is that submitted after lengthy deliberation by an interdepartmental committee of the government headed by the then Assistant Secretary of State Dean Acheson.[4] The position taken by this committee is strongly opposed to restrictive cartel agreements. The essence of their proposal is that the countries of the world be asked to agree to a convention which in substance would adopt in world trade the principles of this country's domestic antitrust policy. Subject to specific exceptions, all restrictive agree-

[4] *The New York Times*, November 4, 1944.

ments, governmental or private, in international trade would be opposed. Exceptions would be recognized:

a) where national defense is involved;
b) for the purpose of conserving scarce and vitally needed commodities;
c) where public health and morals are involved, as in the case of narcotics;
d) in cases of acute crisis.

Supervision would be entrusted to an international body somewhat similar to the Federal Trade Commission. International agreements, necessarily non-restrictive in character, would be filed with this organization. The plan also calls for modification of the patent systems of the countries participating in the proposed convention. Following the general model of the British patent system, compulsory licensing is advocated with the stipulation that patents must be worked within the country if they are to be binding.

Wendell Berge, whose position as head of the Antitrust Division of the Department of Justice gives his words particular importance, has presented recommendations for solving the international cartel problem which, like the proposals of the Acheson Committee, are based fundamentally on our existing antitrust policy, but are somewhat less international in form and scope. In brief, Mr. Berge recommends the: [5]

a) Encouragement of domestic research. This would be designed to reduce the need for American companies to obtain the results of foreign research.

b) Elimination of the waste and misuse of resources consequent upon the artificial support of particular in-

[5] Berge, *op. cit.*, pp. 246-249.

dustries. This presumes, at the same time, avoidance of the exploitation of labor through maintaining wage and health standards.

c) Encouragement of American competition in foreign and domestic trade. A vigorous policy would be carried on to combat monopolies and cartels.

d) Creation of an international forum for hearing complaints relating to monopoly practices.

The Subcommittee on War Mobilization headed by Senator Kilgore submitted a number of recommendations on international cartels after prolonged hearings and investigation.[6] This set of proposals is distinguished from the others chiefly by the emphasis it placed upon measures to curb German economic power. Specific recommendations include the following:

a) Outlaw cartels for the sake of promoting an expansionist era in foreign economic relations. International economic agreements should be made only between governments. With as few exceptions as possible, foreign trade should be conducted through private, competitive channels.

b) Remove Germany's primary industries to devastated areas. Survey Germany's property in foreign countries with a view to its possible confiscation. Retain patents seized by the federal government and make provision for their licensing.

c) Revise the patent laws to require that any discovery originating abroad be licensed to any American producer who wishes to use it on a non-exclusive basis upon payment of a reasonable royalty.

[6] Part I, Findings and Recommendations, Washington, Government Printing Office, November 13, 1944.

d) Establish an organization in which representatives of different countries can exchange technical information.

In light of the policy, officially adopted at the time of the Big Three Conference at Potsdam, of reorganizing German industry and eliminating "excessive" cartelization, the attitude of American officials on this question assumes more than passing historical importance. Well before the end of the war with Germany, specific proposals had been put forward which, while nominally directed toward breaking up German cartels, seemed well suited to preventing Germany from ever recovering a leading place in international markets. Among the most sweeping of these proposals were the recommendations set forth by Assistant Attorney General Wendell Berge:

We must do more than to prevent the resumption of these cartel agreements. If we are going to destroy Germany's military powers, we cannot permit these cartel agreements to be resumed and we must develop and apply a program to control and to break up the monopolistic firms of Germany.

The elements of this program would be as follows:

1. We must acquire, as soon as possible, patents and technological know-how which the German firms acquired during the war years and in preparation for the war. We must get into their factories and laboratories in order to get this know-how. The patents and know-how must be made available to the American people.

2. In the future, the work of such German laboratories as will continue to exist must be made available to firms on a general basis in this country. The Germans have made a habit of using their know-how as a means towards military domination. As a national security matter alone, the German laboratories which continue to exist must operate in full view of

the rest of the world and with adequate safeguards so that their discoveries cannot be kept secret.

3. We must break up the German firms. They must be forced to disgorge the securities and stocks of companies all over the rest of Europe and they must not be allowed to exist as powerful monopolies within Germany. The German firm of I. G. Farben, for instance. . . .

4. Some German firms probably ought to be physically removed from Germany and their laboratories internationalized.[7]

It is evident that these proposals went considerably beyond the mere destruction of German cartels. The first recommendation would involve taking priceless technical knowledge away from German producers irrespective of whether they were cartelized or not. The smallest independent inventor would be subject to the same treatment as the most restrictive cartel. The information thus obtained would be made accessible to competitors of the Germans in this and other countries. There is no reference to any safeguard to prevent the information, once it had been taken from the Germans, from being used by cartels organized outside Germany.

The second recommendation signifies that the work of German laboratories, past, present and future, would be made available to firms in the United States. If this were part of a proposal for the general pooling of scientific knowledge—with foreign countries sharing reciprocally in discoveries made in American laboratories—it might be condemned as socialistic, but it would not be discriminatory nor would it suggest an attempt to control German industry

[7] Statement of Wendell Berge before the Subcommittee on War Mobilization, Committee on Military Affairs of the Senate of the United States. Press Release, September 7, 1944, pp. 2-2a.

in general. Even then, however, it would represent only an oblique attack upon the cartel problem. In the form in which it was presented, the proposal suggests nothing so much as a plan to exploit German scientific ingenuity or—to the extent that the provision tended to suppress German investigation by removing incentive—to maintain German enterprise in a subordinate position through simple compulsion.

A case could perhaps be made for the remaining two recommendations on grounds of equity and military security. For the case to be convincing, however, the recommendations must to be interpreted as applying to particular enterprises and types of industries rather than as granting blanket authorization, as the words seem to suggest, to exercise any sort of arbitrary control over German industry.

The proposals advanced by the Acheson Committee, Mr. Berge and the Kilgore Committee, all originating from official sources, are representative of the proposals based upon a categorical repudiation of cartels. A bill was introduced into Congress by Representative McMurray to prohibit international agreements which were aimed at limiting production, fixing prices, establishing quotas or allocating markets. It also called for the repeal of the Webb-Pomerene Act and for establishment of an international committee to study the problem of restrictions in international trade. This bill was unrelated to the foregoing proposals but resembled them in its attitude of firm opposition to cartels.

PROPOSALS DESIGNED TO PERMIT CARTELS ON A RESTRICTED BASIS

The leading proposal for limited authorization of cartels is that advanced by the National Foreign Trade Council on

the basis of an extended memorandum prepared by the law firm of Curtis, Mallet-Prevost, Colt and Mosle. The objections advanced against this country relying on our antitrust laws for the regulation of foreign trade are of more than passing interest. It is contended that such a policy cannot reach many harmful activities engaged in by foreign businesses or remove the causes of abuses where abuses exist, fails to recognize that special considerations may require the application of different principles in foreign trade from those followed in domestic trade, and places the control of foreign business in a department of the government not charged with foreign economic or political policy.[8] The antitrust laws, it is said, may work at cross purposes with our foreign economic policy.

The central feature of the solution recommended by the Foreign Trade Council is the granting of "revocable approval" for cartel-like business agreements entered into with foreigners. A proposed agreement would be submitted to the Department of State where it could be given approval if it was not found to constitute "unreasonable restraint of trade within the United States when considered in the light of the foreign laws and our foreign economic policy," or to restrain the foreign trade of a domestic competitor.[9] The agreement would be considered to have been granted revocable approval unless the Department of State served notification of its disapproval within three months of filing.

The plan proposes that Congress specify the criteria to be observed in determining the reasonableness of possible restraints of trade resulting from international business

[8] National Foreign Trade Council, *Memorandum on Regulatory Measures Affecting American Foreign Trade.* New York, 1944, pp. 109-110.

[9] National Foreign Trade Council, *Resolution on International Business Agreements,* New York, 1945.

agreements. Suggested criteria include national security, conformity with the international engagements of the United States government, regard for the policy and laws of other countries and effect on the total commerce of the United States and the world.

Of particular significance is the provision that "upon revocation of any such approval the Department of State shall give notice to the American parties specifying in what respects the agreement or acts thereunder may constitute unreasonable restraint of trade within the United States; that in such case the parties shall have a period of three months within which to remedy any such restraint of trade and only if they fail to do so within that time can action be instituted under the antitrust laws and such action should be directed only to acts or agreements which continue beyond the three months remedial period." [10]

On the one side, the plan of the Foreign Trade Council is defended as helping to remove the uncertainty that now exists concerning the legality of proposed actions, and as providing protection to business firms against suddenly being attacked for actions long engaged in on the assumption that they were entirely legal. On the other hand, the proposal is open to criticism as affording companies which have been given approval an undue opportunity to see how far they could go in stretching the terms of the agreement, knowing that the worst that could befall them would be to have the approval withdrawn. The plan places the burden of proof very largely on the government and reduces to a minimum the penalty which might be incurred through any infraction, whether voluntary or involuntary, of the spirit of the law. Even when caught, an offender would be al-

[10] *Ibid.*

lowed a period of three months in which he could continue his evil ways.

Despite all that has been intimated to the contrary, businessmen are in no serious danger of being attacked by the Department of Justice so long as they engage in free, independent competition. What is possibly unclear is not what the law desires of businessmen, but how far it may be safe for them to deviate from the law's intention. If the plan of the National Foreign Trade Council were adopted, they would be protected against unfavorable action except where they persisted in an illegal course after having been proved wrong by the government.

Another plan looking toward a quasi-judicial review of international business agreements has been presented by Milo Perkins.[11] Mr. Perkins contends that American business is relatively helpless against well-organized foreign businesses, that we cannot eliminate cartels and that we must "make our foreign trade policy fit the realities of an era which has already gone a long way toward cartelization."

To this end a Board of International Trade would be established, headed by the Secretary of State and comprising, it is suggested, the Secretaries of War, Navy and Commerce, the Attorney General, the chairmen of the Senate Foreign Relations Committee and the House Foreign Affairs Committee and two men to represent the public. There would be obligatory registration of international cartel agreements, and the Board would have the power to approve or disapprove them. Decisions would be rendered quickly and there would be continuous review of agreements which had been approved. The Board would also

[11] *Harpers*, November, 1944, pp. 570-578.

pass upon intergovernmental commodity agreements, which Mr. Perkins expects to assume increased importance.

Early in 1944, Senator O'Mahoney introduced a bill in the Senate which, like the proposals of Mr. Perkins and the National Foreign Trade Council, would provide for registering international business agreements. The bill would require the registration of any foreign contract entered into by a domestic company or by a foreign company doing business in the United States if the contract contained any of a variety of restrictive provisions or provisions for joint operations or for licensing or assigning patents.

PROPOSALS DESIGNED TO FACILITATE CARTELIZATION

The dividing line between recommendations aimed at merely permitting and those aimed at facilitating international cartels is necessarily somewhat vague. The basis of distinction is between attitudes of tolerance and of encouragement, and may depend as much on the expressed beliefs of the proponent of a plan as on the provisions of the plan itself. It is to be noted that any recommendation looking toward the authorization of cartels is more likely than not to begin with an endorsement of free enterprise and a condemnation of past practices of cartels.

One of the simplest, and at the same time most ingenious, of the proposals to facilitate cartelization is that advanced privately by a leading export executive, Heman Greenwood, vice president of the Carrier Corporation. Pointing out that businessmen have, in fact, been able to operate successfully under existing laws, Mr. Greenwood argues that the most practicable procedure would be to amend the Webb-Pomerene Act to remove present uncertainties and provide needed safeguards. He recommends a clear and

unequivocal declaration of what constitutes unlawful restriction within the country. On the international side he would encourage the establishment of Webb-Pomerene Associations in as many industries as possible, and he would make entry into these associations absolutely open at all times providing a newcomer accepts the rules and regulations of the association and the corollary responsibilities.

From an economic standpoint, the provision for free entry into the association constitutes the central feature of Mr. Greenwood's proposal. Not only would this extend most broadly any socially beneficial results of the agreements; the existence of freedom for any producer to enter a cartel whenever it became profitable to do so would help to provide protection against the use of cartel agreements to maintain excessive prices. In substance, the proposal integrates facility to combine for the purpose of achieving economies with reliance upon competition, as expressed in freedom of entry into the associations, to protect the public against monopolistic abuses.[12]

Most of the other plans for facilitating cartelization look toward the establishment of administrative machinery for the guidance and supervision of cartel policies. In some of the plans the administrative organization would be under governmental control, either national or international, while in others the control would be maintained by the industries themselves, with or without governmental participation. In view of the subordinate role accorded to free competition, it is not surprising that the majority of these proposals have originated abroad.

An executive of the N. V. Philips Company, which domi-

[12] An association of the type contemplated would resemble a closed shop with an open union.

nates the electric light industry abroad, has drawn up a plan for general cartelization based on the idea of control by producers, with the government chiefly responsible for formulating rules and safeguarding the interest of the consumers. The essence of his proposal is the establishment of an international board in each industry drawn from the principal producers in that industry. This group would be subject to approval by the governments concerned and would be charged with adjusting difficulties arising out of transactions extending across international boundaries.

The most ambitious proposal for international cartelization is the plan for a World Trade Alliance advanced by the Federation of British Industries, an association of British industrialists not unlike the National Association of Manufacturers. A system of associations formed in particular industries is contemplated under this scheme, with large associations to embrace the smaller. Legislation would be adopted making it possible to compel a minority of an industry to join an association in cases where it covered a sufficiently large part of the industry. The World Trade Alliance would provide for participation by business concerns in foreign countries, and its activities would extend to helping to plan and finance the economic development of less advanced parts of the world.

SUMMARY OF MAJOR RECOMMENDATIONS

There is general agreement, among both supporters and opponents of international cartels, on the desirability of change of one sort or another and on the need for definite legislative action. At the same time, continuance of our antitrust policy within the United States is usually endorsed and lip-service, at least, is paid to the preservation of a high

degree of competition. With these as common bases, the following major recommendations are embodied in one or more of the proposals mentioned:

The laws governing the international activities of business should be made clearer and more explicit.

Changes in administrative organizations are called for. Specific suggestions include the strengthening of existing machinery, establishment of new governmental agencies within the country and creation of a governmentally sponsored international control organization under private auspices.

It should be rendered easier for a businessman to determine in advance what he is or is not allowed to do. Machinery should be established to afford "revocable approval" of the legality of contemplated courses of action.

Consideration should be given to consumers' interests, conceivably through governmental or consumer representation.

Existing patent provisions should be modified.

Entry into cartels where they are allowed to continue should be made as free as possible.

Where cartels are desired, the authority of the government should be invoked, if this is necessary, in order to compel a small minority to join with the rest of the industry.

The remaining features of the proposals are less important or are concerned with particular policies to be followed or the means of carrying them into effect. Some of the provisions listed either represent alternatives or are exclusive, while others are entirely compatible with one another.

Chapter VIII

TOWARD A SOLUTION OF THE CARTEL PROBLEM

THREE MAIN courses of action are open to this country in attempting to deal with international cartels; they are permission, prevention, and selection. For a problem which shows as many shades of variation as cartels do in type, character and effects, no simple solution can be wholly satisfactory. A blanket prohibition of American business participating in international cartels would be as undiscriminating as *carte blanche* to join them—though it would be considerably less hazardous.

The policy which would most nearly approach the ideal would also be the most difficult to apply, namely, a policy of judging each case on its merits with discretionary power to decide what course to allow in each instance. A fully discretionary policy toward cartels is precluded by the difficulties of administration. The most that can be asked is some degree of latitude on the part of the administrative authorities to permit practices of a cartel character when they can be shown to be clearly in the national interest.

A cartel policy for the United States must accord as closely as possible with the country's economic and political ideals and at the same time be realistic enough to be operational. The task of working out such a policy falls logically into three main divisions: determination of basic objectives, planning of a structure of supervisory organization and formulation of administrative standards.

BASES OF CARTEL POLICY

A policy on international cartels is merely one aspect of economic policy in general, just as economic policy is one aspect of public policy. It must be judged with reference to other governmental measures, and always in the light of fundamental objectives of national policy. Broad national objectives include preservation of national security, protection of public health and morals, freedom of the individual both politically and economically, maintenance of a relatively high level of employment and encouragement of economic and cultural progress. These are not alternative aims; the goal is to achieve them all. Since that may never at any one time be fully possible, it may become necessary to effect a balance among them or to sacrifice a little in one direction in order to gain a little in another direction. Sufficient flexibility must exist to allow for the emergence of new objectives and for changes in the relative importance of old.

The differing, and possibly conflicting, interests of various groups in the population must be reconciled as far as is reasonable. Nor is it accurate to lump the different groups into broad categories such as producers, consumers and labor. Not one of the various social groups is homogeneous: all owners are also consumers; most consumers are also workers. There may, indeed, be greater scope for conflict among different categories within the major groups than among the major groups viewed collectively. Thus freedom to enter into restrictive agreements, which might give an advantage to one group of businessmen, would probably for that very reason injure competing or dependent businesses. At the same time, the issue of monopolistic practices

by particular groups of businessmen cannot be divorced from the policies followed by other groups within the social structure. If trade unions establish a restrictive monopoly, however, that fact does not justify the existence of a monopoly on the side of the producers. It simply means that there are two problems of monopoly to be attacked rather than one.

Not all groups are equally capable of safeguarding their respective interests. A variety of ways may exist for overcoming threats to particular interests, of which the regulation of cartels is only one. It is even conceivable that by governmental supervision or consumer representation the major disadvantages ordinarily associated with cartels might be overcome. Not only must any measure be judged in terms of alternatives, but it is futile to weigh proposals by standards of perfection. No policy can be expected to be free of defects and it is likely that none will be entirely devoid of virtues. Both virtues and faults must be assessed according to the way they balance out in comparison with the virtues and faults of some alternative policy; and for the comparison to be significant, the alternative must be attainable.

Ultimately, our entire approach to the problem of monopoly is likely to be determined largely by our philosophical attitude which, in turn, is influenced by our intellectual heritage. "If we had worked downwards from monopoly, instead of upwards from competition, in evolving the level at which industry had a proper combination of both the competitive and the administrative elements, then we would have regarded pure competition as the limit of excessive development, just as we now regard pure monopoly. We would have spoken of the danger of pure

disorganization, instead of the danger of exploitation." [1] The difference in public policy toward business agreements in England and the United States is partly attributable to the fact that, with the same common law background, the British have emphasized freedom of contract while we have emphasized freedom of domestic trading.[2]

The public attitude toward monopoly is influenced also by our conception both of how we want the economy to behave and—what allows still greater room for disagreement—of how we believe it would behave in the absence of a positive economic policy.[3] For this reason, an appeal to historical evidence to substantiate the case for or against cartels is a useful but necessarily inconclusive guide to the formulation of public policy. The purpose of such an appeal is to help in determining what would result from following a particular policy; but history cannot accurately tell what would occur under conditions different from those which actually prevailed—even when the difference lies only in the existence of the policy we are attempting to formulate.

From the standpoint of social policy, what is fundamentally significant is not necessarily the cartels themselves, for they are simply a particular type of business organization, but the source of the economic power whereby cartels are able to carry out the policy we may disapprove. If that power is inherent in the cartel, we can

[1] D. H. Macgregor in Robert Liefmann, *International Cartels, Combines and Trusts*, London, 1927, pp. xiii-xiv.

[2] Cf. Diamond, *op. cit.*, p. 826, and Joseph E. Davies, *Trust Laws and Unfair Competition*, Washington, 1916, p. 233.

[3] "A theory which treats capitalism as a system tending toward a position of equilibrium self-regulated through the adjustment of costs and utilities through the market, cannot see the necessity of stabilization by conscious direction; it can only regard a system with credit controlled and industry combined as an 'organisierte Unwirtschaftlichkeit.'" —Warriner, *op. cit.*, p. 149.

legitimately make cartels the object of proposals for reform. If it is not, then cartels should be regarded merely as an instrument for exercising that power, and the results to which we object as the consequences not of cartels but of some root cause that lies back of them.

Any attempt at economic reform which fails to look behind the immediate manifestation of an abuse is reasonably certain to fall short of an adequate solution. To abolish cartels without doing anything about patents, would leave the possibility that many of the same consequences would break out in some other form. At the same time it is clear that because of characteristics inherent in the nature of cartels some of the tendencies to which we currently object can be eliminated only by getting rid of cartels directly.

The question of the desirability or undesirability of cartels is inseparable from the type of economy we desire, our form of government and the men placed in authority. It is no accident that cartels were generally favored in Nazi Germany and are generally condemned in the United States. The nature of cartels, as of other forms of monopoly, is to be restrictive. The restrictive effects of German cartels abroad were in harmony with National Socialist aims, while the restrictive tendencies at home were capable of being offset or controlled by authoritarian means.

In American economic life today international cartels are, generally speaking, out of place. Their inherent tendency to be restictive is antagonistic to the expansionist objectives toward which we aim, while adequate means of coping with their restrictive tendency are incompatible with the preservation of our democratic institutions. Under the circumstances, a policy of categorical repudiation of

any and all cartel agreements is precluded only by the possibility that the restrictive tendency is not universal and cases may arise where cartels can serve the cause of economic expansion and progress. The same qualification, coupled with the fact that we start with a situation where cartel agreements already exist, makes it necessary to recommend a more complicated supervisory organization than would be required if its only function were to enforce a prohibition against every sort of cartel practice.

THE STRUCTURE OF ADMINISTRATIVE CONTROL

Suggestions for the creation of an administrative organization to supervise cartel policies relate to three separate phases, namely, the international aspects, internal administrative organization and internal legislative changes. Of the three divisions, the second, which concerns the supervisory machinery to be established within the federal government, is the most extensive and, at the present stage of discussion, the most important.

International Aspects

In the interests of effectiveness of accomplishments and harmony of procedure, an international organization should be established which will concern itself with international cartels. Such a body might be part of an organization dealing with international business problems in general. In view of the relative magnitude and character of the problems, it seems likely that a body somewhat similar to the International Labor Office might succeed in accomplishing as much in the field of business as that body has done in the field of labor.

The duties of an international organization on business arrangements would include, among other things, a study of the questions relating to international cartels and ultimately the formulation of measures for meeting the cartel problem. Membership on the international body might embody representation of different groups having particular interests, such as capital, management, consumers, labor and agriculture. The activities and possibly the administration of an international body of this character could be organized to deal separately with commodity agreements, as well as with the type of private cartel agreement under discussion.

The action of the United States in the international field should not, however, be confined to the creation of an international organization to supervise cartels. As soon as possible, the policy this country intends to follow toward cartels should be presented to the world clearly and openly, and efforts should be made to secure agreement with other countries on policies favorable to a mutually satisfactory solution of problems relating to international cartels. We cannot, of course, expect to impose our views on free competition upon other countries against their will, any more than we intend to accept their views on cartels. Nevertheless, it may be possible, without asking them to adopt our attitude on individualism and competition in its entirety, to induce them to move in somewhat the same general direction or, at any rate, to remove any added incentive for them to move in the opposite direction. The least we can hope for is that, by stating our policy on cartels the conflict between our own and others' policies may be reduced to a minimum.

Internal Administrative Organization

Instead of a single agency in the government charged with covering all phases of the cartel problem, there would be advantages in dividing up the work among a number of different agencies which would remain in close touch with one another's activities. This procedure would make not for greater complexity but for less, since it would draw upon existing agencies of the government. Moreover, it would avoid duplication by charging the different agencies with responsibility for phases of the problem with which they are best equipped to deal and with which they would in any case be concerning themselves. The structure of an interdepartmental organization for dealing with the problem of international cartels might take somewhat the following form:

a) An Office of Economic Policy, probably in the State Department, whose task it would be to study at all times, in peace or war, the political and military significance of the activities of American business. This would not, of course, be the full extent of its duties, and presumably its authority to apply correctives would remain to be decided. Such an agency would be expected to obtain currently the information that would have made it possible to avoid many of the pitfalls into which American enterprise, in its relations with foreign businesses, is accused of having fallen during the 1930's. It would place the responsibility for possessing this knowledge and taking appropriate action squarely where it belongs, upon the shoulders of the government.

The Office of Economic Policy would concern itself intimately with questions of national security. In order

to fulfill its strategic responsibilities most effectively the Office might well embrace or participate in an interdepartmental committee like the committee established to facilitate the work of the Reciprocal Trade Agreements Program and the committee under Assistant Secretary of State Acheson which made a study of the cartel problem. A standing interdepartmental committee of this character would include representatives from the War and Navy Departments, probably from the departments of Agriculture, Commerce and Justice, and possibly from other branches of the government.

b) An Office of Foreign Legal Information. If it is true, as has repeatedly been said, that the laws and the administrative procedures of foreign governments make it desirable for American corporations to participate in cartels, it is essential that the business public should be informed concerning these laws and procedures. The full disclosure of such information would be of assistance to American companies doing business abroad. It would also provide the information needed for applying correctives through other channels, e.g., by diplomatic protests against possible infraction of our most-favored-nation agreements with foreign governments. The duties of such an office could best be carried on separately from the Office of Economic Policy, even though a close liaison between the two would necessarily exist. It is possible that existing agencies in the Bureau of Foreign and Domestic Commerce or elsewhere could discharge this function satisfactorily if methods were improved for getting their findings before the public.

c) An agency whose function would be to examine business agreements from the standpoint of their relation

to our foreign trade policies. Partly because cartel agreements have been so extensively used to restrict imports into the United States, these duties might appropriately be assigned to the United States Tariff Commission. This agency would be charged with responsibility for full knowledge of the facts relating to the effect of international business agreements on exports and imports. It would attempt to determine whether the purposes of the agreement were being fulfilled and, if possible, whether it was exerting any covert, and particularly any restrictive, influences. Provisions might be introduced requiring that international business contracts be registered with this body, subject to safeguards against disclosure of information properly regarded as confidential.

d) An enforcement agency. This would continue to be the Department of Justice. While improved facilities might well be afforded for consultation by businessmen, anything as specific and binding as the "revocable approval" of particular agreements proposed by the Foreign Trade Council is administratively dangerous and should be refused. The enforcement agency would have at its disposal whatever information on international business arrangements was gathered by other divisions of the organization and would also maintain adequate staff and facilities of its own for obtaining additional facts.

In this plan of administrative organization, functions would be clearly defined. The Office of Economic Policy would be essentially, as its name suggests, a policy body. In addition to having power to initiate action to the extent that its role in national security required, it would be charged with principal responsibility for proposing modifications in

the law when circumstances indicated. The Department of Justice would retain its responsibility for enforcement and would, of course, have a voice in effecting such changes in the law as might seem desirable from the standpoint of preserving healthy competition in the foreign and domestic operations of American business. The other two divisions of the organization would be essentially of a service character; they would supply information which is allegedly needed for the successful conduct of business abroad and, more importantly, information for evaluating the effects of international business arrangements in which United States enterprises are involved.[4]

Legislative Changes

Modification of the present patent law, last changed in 1836, is urgently to be desired. The original purpose of the patent clause of the Constitution was to provide incentives that would serve "to promote the progress of science and useful arts." It is clear that in some instances, perhaps in many, patent rights have been employed instead to establish and maintain restrictive monopolies. This perversion of the patent clause could be rendered more difficult by adopting provisions such as exist in England and elsewhere, requiring that a patent be worked if it is to retain its validity and making licensing compulsory, at least where abuse of patent

[4] The precise form of the administrative organization outlined here is not essential to the discussion. Its purpose is not so much to provide a blueprint as to call attention to some of the elements an administrative structure should contain and some of the functions it would need to perform. The pattern suggested would have the advantage of building upon existing agencies of the government, thereby simplifying the task of organization while making it possible to draw freely upon existing experience. Whether these virtues outweigh possible disadvantages is a matter for further investigation.

rights has occurred. It must be observed, however, that a revision of the patent system along these lines could be expected to have repercussions on the domestic operations of business even greater than its effects on cartel activities. Opinions may differ as to whether this constitutes a drawback or a further advantage of the recommendation for amending the law of patents.

The Webb-Pomerene Act, apparently as it was originally intended and certainly as it was originally applied, related only to the organization of selling associations for the joint handling of export trade by companies which operated independently in the domestic market. In substance, it was directed toward enabling business to organize on one scale for domestic business and on another scale for foreign business. Only after the far-reaching executive decision of 1924 was the way opened to form Webb-Pomerene associations for the purpose of dividing markets and controlling prices and conditions of sale. Webb-Pomerene associations of the type originally formed were adapted to the realization of some, at least, of the theoretically possible economies of cartelization, while the type of association that could be organized under the later interpretation of the Act was more favorable to the introduction of restrictive practices. No thorough-going study of the Webb-Pomerene Act has ever been made. Such a study might well be undertaken with a view to determining whether to repeal the law, return it explicitly to the original, pre-1924, interpretation or amend it in some other way.

Finally, there should be a specific legislative reaffirmation of the Sherman Act philosophy as the basis of American business practice abroad. What needs to be placed beyond doubt is not that there should never be any business agree-

ment that could be construed as a cartel, but that the laws and the courts are opposed to a restrictionist policy however it arises; that what matters is not the form of business organization but the fact of restrictive consequences; and that, by and large, competition and freedom of the individual are regarded as, by presumption, the surest safeguards against objectionable practices in production and trade.

STANDARDS FOR ADMINISTERING A CARTEL POLICY

The primary basis for administering the future cartel policy of this country resides in the major propositions that the United States is determined upon an expansionist economic policy and that international cartels are inherently restrictionist in tendency. It follows that cartels are to be presumed contrary to national policy and should be forbidden. This is the basic working rule of an effective cartel policy.

The idea of having no law at all on cartels other than that they should be reasonable—leaving it to the courts to decide what is reasonable—would have greater attractions if it were not for the extraordinary difficulty of applying any such policy. It may be noted that Germany introduced a rule of reason for cartels in 1923 but was unable to make it work.[5] The great difficulty is that the "reasonableness" of a cartel's objectives and "fairness" of the price it charges are likely to be incapable of final proof or disproof.[6]

[5] Notwithstanding the claim that it was a "deft intervention in economic affairs designed to check the abuses attending industrial combination and to preserve the attendant benefits."—Warriner, *op. cit.*, p. 126.

[6] Thus in the case of a cartel in an over-expanded industry the fairness of the return realized by a cartel cannot be established by com-

A further disadvantage of relying upon a high degree of administrative discretion is that it would raise to a maximum the uncertainty that exists concerning the future application of the policy toward cartels. Even a relatively bad law is easier for business to accommodate itself to—if it can be counted upon to remain constant—than better laws which are subject to unpredictable change, whether in content or interpretation. One of the main objections to the policies we have followed in the past is that they have been neither consistent nor continuous. The introduction of a rule of reason could only aggravate this defect. On the other hand, close adherence to a simple, clear and enforceable rule against cartels would go far to overcome it.

The second guiding principle whenever an exception to the rule against cartels is under consideration is that the burden of proof should be on the applicant seeking the exemption. He should be obliged to demonstrate that his proposed agreement either was not restrictive or was warranted on the basis of other considerations. These other considerations would comprise, in the main, the broad aims of national policy listed earlier.

The basic test for distinguishing a good agreement from one that is objectionable—a test supported by logic and by the practical applications arrived at under the stress of war conditions when numerous departures from competition were authorized—is that those practices may be permissible which facilitate the introduction and diffusion of more

parison with other industries, since the very fact of over-expansion signifies that on economic grounds a lower rate of return is called for than would be warranted in an industry where there was no over-expansion. One of the greatest virtues of competition is that, despite the possibility of serious aberrations, it comes nearer than any other means to producing a price which, in the long run, is logically and objectively defensible.

efficient techniques in production and distribution, and those practices are undesirable which, in the long run, involve restriction. Other considerations such as stabilization of prices and avoidance of minor fluctuations in output, notwithstanding the prominence so often given them, are subordinate or incidental to the ultimate objective of the long-run expansion of supply. Even the maintenance of full employment is a means to that end and not the end itself.

Thirdly, cartel policy is an integral part of our international economic policy. Without coordination there is a strong probability that one part of our commercial policy may sabotage another part. It is idle, for example, to expect the Trade Agreements program to contribute effectively to the expansion of international trade if the way is left open for private groups to erect new obstructions to trade. Moreover, the action we take on cartels cannot be divorced from its effect upon the actions of other countries. We cannot assume constant conditions abroad; to a considerable extent our course will determine what those conditions will be.

The interdependence of our policies and the policies of other countries is a measure of the responsibility which attaches to any decision we reach; the course we follow on cartels will influence the development of international commercial policies in the coming years. Adoption by this country of a combative, nationalistic policy on cartels may be counted on to strengthen the support for still more intransigeant policies abroad. On the other hand, maintaining a freer, more competitive trade policy will help to turn the whole tide of international commercial policy, as relates not only to cartels, in the direction of greater individual freedom and opportunity.

The injurious effects of such restrictive agreements as continue to exist in international commerce will be greatly moderated by our own determined pursuit of freedom and competition. As Professor Ben W. Lewis has said: "We can move vigorously toward an international agreement to compete; failing its accomplishment we can still have a lot of competition by competing." [7] Already the task of mitigating the future influence of international cartels has been simplified by the reorganization and control of German industry inaugurated by the peace settlement.

The cartel question raises international issues of a political and military, as well as economic, character. The broader consequences of cartel activity can by no means be ignored, but it is asking too much to insist that economic measures provide at the same time a solution for problems which lie primarily in the fields of diplomacy and military affairs. The most and the least that can be asked is that the solutions offered for the economic problems shall not render appreciably more difficult a solution of the other problems.

Finally, the necessity of unending watchfulness in preventing the rise of forbidden monopolistic practices has been fully demonstrated in the experience of the United States. The second half century of American antitrust policy has opened with more vigorous action by the authorities than ever characterized the years that went before. Fifty years after we started in to root out domestic monopoly, that is, we still find it necessary to work at the task as strenuously as ever. The price of free competition no less than of liberty—of which it is a close relative—is eternal vigilance.

[7] "The Status of Cartels in Post-War Europe," *The Commercial and Financial Chronicle*, July 5, 1945, p. 109. Elsewhere in speaking of foreign cartels (p. 104), Mr. Lewis remarks, "Maybe you can't destroy 'em, but you can certainly mess 'em up!"

Chapter IX

CONCLUSION

IF GERMANY had won the war cartels would have become the dominant form of business organization throughout the world, and this country would have had no choice but to accommodate our economic conduct to it. The defeat of the totalitarian powers did not signify that an answer has been given to the question of what place cartels will occupy in the postwar world. It meant only that the question remains open and we still retain freedom to decide what the answer will be.

The cartel question is one facet of a fundamental problem of social and economic policy which confronts every country of the world, the problem of where to establish a balance between freedom and control. If we think of possible governmental policies toward economic life as a line stretching between the extremes of Laissez Faire and Totalitarianism, the issue turns on what point along that line we should adopt as our goal. It is not that complete Laissez Faire is dead; it has never existed in modern life, any more than complete Totalitarianism has existed. But there has always been the problem of where to effect a working compromise between the ultimate extremes. The question is particularly acute today because of increased doubts that the answers to the problem given yesterday will suffice to meet the practical exigencies of tomorrow.

The issue of cartel policy has become enmeshed, in the minds of both friends and enemies of cartels, with the question of economic planning. By a curious twist, "planning"

has become an ugly word in the eyes of many, at a time when plans of every type and size are being put forward; when every business has its postwar planning committee and all business its Committee on Economic Development; when the country plans for sixty million jobs and the rights of returning soldiers; and when one international conference succeeds another, each with plans of planetary dimensions.

The truth of the matter is that we are all in favor of good planning and against bad planning, just as Coolidge's preacher was against sin. It is often difficult to find the dividing line between the two, as it is between good and evil, but that does not mean that we can avoid the issue. Nor does it signify that it is useless to insist upon the distinction.

Mere interference with individualistic competition does not constitute planning in a social sense any more than random scratches on an architect's pad make the blueprint of a house. The term economic planning when applied to the protective tariff in this country was always a misnomer, and it is no less inappropriate to cartels; for the essence of any economic planning that deserves the name is an attempt to integrate particular measures and policies which are concerned with the individual parts of the economy into a consistent whole. Either tariffs or cartels might conceivably be adapted to use as instruments of a comprehensive program of economic planning. It is reasonably certain, however, that if they were so employed they would lose most of their appeal for the groups now favoring them, for the simple reason that the planning would be guided by entirely different considerations from those which have governed tariffs and cartels in the past.

The problems toward which economic policy is directed are bound to confront us whether we "plan" or not, though conceivably the course we adopt may aggravate rather than alleviate them. But the possibility of undue interference with private initiative or excessive meddling with the economic system is no justification for closing our eyes to the existence of remediable ills. The aim and warrant of all action in the field of public policy is to contrive techniques and safeguards which will facilitate the realization of benefits and prevent or impede the emergence of disadvantages. The fact that abuses may occur, though pertinent, is decisive only if it is impossible to remedy the abuses, and even then only if the attendant disadvantages outweigh the attendant benefits.

The fundamental objection to cartels is not simply that they represent a departure from free competition—except to those who prize freedom to compete as an end in itself. Rather it is that the effect of such a departure hinders attainment of major objectives of public policy. It is not that cartels may favor a particular group, the rich against the poor, large corporations against the small, producers against consumers. It is rather that, in its ultimate tendencies, cartelization is restrictive of much more than just the freedom to compete. By interfering with freedom of access and entry, cartelization at the same time interferes with expansionist influences in the determination of output, capacity and survival of the fittest producers. It is this inclusive and far-reaching restrictionism which is so thoroughly inimical to the national interest.

Opposition to giving our businessmen a free hand in their foreign operations is not based upon solicitude for "the poor foreigner." It is founded on the anticipated effects of such a

policy on the American economy, viz., that it would contribute to the restriction of imports and exports, and thus reduce the total volume of American foreign trade. Such a reduction would entail the sacrifice of some of the advantages of international division of labor, and would tend to render more difficult the maintenance of full employment in the United States.

Those who favor limiting the freedom of American businessmen to combine in foreign trade are no less desirous of being realistic than those who would allow participation in international cartels; but they disagree on what constitutes realism. Both believe that their recommendations are in the interest of this country; they differ in their interpretation of where the national interest lies.

In the not inconceivable case where cartels are expansionist, or otherwise in accord with recognized social objectives, the cartel question is whether, assuming that departures from individualistic competition are found desirable, we wish to have the departure administered by a small group of businessmen interested in profits, or by the government. There is the further question of alternative methods of approaching, other than by free competition, the objectives we have in mind. For example, the maintenance of stock piles may be regarded as preferable to cartels as a means of promoting cyclical stability, or the maintenance of governmental research laboratories may be preferred to private patent pools as a means of advancing technical knowledge in industry.

Even those who are most strongly in favor of economic planning may question the usefulness of cartels as a means to that end. For privately administered cartels represent planning at an intermediate level between the individual

enterprise and society as a whole, and may, assuming traditional objectives of policy, be in conflict either with economic planning as ordinarily conceived or with individualism. Whether or not cartels fit in with national planning is likely to depend in considerable part on the nature of the plans and on who are doing the planning: cartels were approved by the planners of Berlin but are condemned by the planners of Washington.

There are no absolute answers to questions of social policy, or if there are, there are no answers that will satisfy everyone as to their correctness. The same consideration that impresses one person as a disadvantage may strike another as an advantage of a particular course of action. There is no point whatever in challenging the intelligence, honesty, social conscience or patriotism of those who disagree with us on social and economic policy. For the extent and vigor of disagreement on social questions is one manifestation of the amazing capacity of the individual to convince himself that what seems best for him must also be best for society: it makes no difference whether the issue is the Townsend Plan, tariffs, silver or cartels.

Even with the fullest presentation of evidence, not everyone will arrive at the same conclusions on questions of social policy; and ultimately a decision must depend upon a general consensus. That decision may be one with which many of us violently disagree; indeed, it may not be a correct decision by any rational standard. But over a reasonable period of time a larger proportion of correct decisions will be reached by this process than by any other method. This we believe if we believe in democracy.

A number of years ago Professor Wesley C. Mitchell defined the basic economic problem before the world as

"the problem of developing an economic organization that will enable the citizens of a modern state to buy from one another what modern industrial methods enable them to produce." [1] While this statement was advanced in the midst of world depression, it applies as truly in a world returning from war to peace. In seeking a solution for the problem of preserving a high level of economic activity we, in this country, are determined to maintain as great freedom for the individual as producer and as consumer as is compatible with the basic objective.

In order to maintain a free economic society it is necessary to build upon rather than attempt to override the inherent, egocentric impulses of human nature. Public policy should proceed from the expectation that producers will be more concerned with increasing their profits than with saving money for consumers. If the same action promotes both ends, well and good, but if not, businessmen will choose what they believe to be most profitable for them; they will consult their own particular interests just as consumers consult theirs. This circumstance provides no reasonable ground for reproaching either producers or consumers—it is merely a description of the way the world operates. One might as well complain because the sun rises in the east rather than in the west as to object to individuals pursuing their own interest.

The substance of the liberal tradition in economics was that market forces, if allowed to operate freely, would automatically harmonize the interests of producers and consumers; that is the gist of Adam Smith's famous "invisible hand" and of the "economic harmonies" of the

[1] Columbia University Commission, *Economic Reconstruction*, New York, 1934, p. 82.

French writer, Bastiat. Unfortunately for its peace of mind, the world has lost much of the confidence it once had in the beneficent sufficiency of natural market forces. It is increasingly clear that if we desire to live in a world where individuals are free to choose, both as producers and as consumers, that freedom must be defended against invasion by monopolistic interests as surely as from undue encroachments by the government. The government must assume major responsibility for providing conditions which will enable the free choices of individuals to function to the greatest net good of all. Otherwise we shall have to resign ourselves to administrative controls which, by restriction and artificial stimulus, will stultify the free choice of individuals as the chief regulator of economic activity.

Public policy may undertake to facilitate the automatic adjustment of the market in some directions and to substitute something else in its place in other directions. It might be directed, for example, toward curbing or preventing international cartels where competition is clearly superior and toward facilitating them where they seem to offer net advantages. It would provide safeguards against abuses where a need for cartels has been found to exist, and it might establish additional instruments, such as intergovernmental commodity agreements, in the hope of performing similar functions more effectively.

The general rule remains, however, that in the United States cartels are to be presumed contrary to the public interest. The reason for this presumption is simple and clear; cartels involve, by definition, a departure from competition. Because of that fact they constitute a repudiation of the aims and methods to which the competitive system is dedicated. Every unnecessary departure from competi-

tion renders it more difficult to make a free enterprise economy function. The time has not yet come when we are willing voluntarily to jettison a capitalistic system based on free individualism. If we ever do decide to surrender our free enterprise system, it is safe to predict that the surrender will be made to the chosen representatives of the state, and not to groups of private monopolists.

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